

EXAMINATION OF AEC CONTRACTS WITH THE U.S. GOVERNMENT

HEARING

BEFORE THE

COMMITTEE ON OVERSIGHT
AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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EXAMINATION OF AEY CONTRACTS WITH THE U.S. GOVERNMENT

TUESDAY, JUNE 24, 2008

HOUSE OF REPRESENTATIVES,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m. in room 2154, Rayburn House Office Building, Hon. Henry A. Waxman (chairman of the committee) presiding.

Present: Representatives Waxman, Cummings, Tierney, Watson, Lynch, Norton, Davis of Virginia, Platts, Issa, and McHenry.

Staff present: Phil Barnett, staff director and chief counsel; Kristin Amerling, general counsel; Karen Lightfoot, communications director and senior policy advisor; David Rapallo, chief investigative counsel; John Williams and Theodore Chuang, deputy chief investigative counsels; Russell Anello, Stacia Cardille, and Suzanne Renaud, counsels; Christopher Davis, professional staff member; Earley Green, chief clerk; Jen Berenholz, deputy clerk; Caren Auchman and Ella Hoffman, press assistants; Miriam Edelman, staff assistant; Lawrence Halloran, minority staff director; Jennifer Safavian, minority counsel for oversight and investigations; Keith Ausbrook, minority general counsel; John Brosnan, minority senior procurement counsel; Steve Castor, minority counsel; Benjamin Chance, Adam Fromm, and Emile Monette, minority professional staff members; Patrick Lyden, minority parliamentarian and member services coordinator; and Brian McNicoll, minority communications director.

Chairman WAXMAN. The meeting of the committee will come to order.

Today's hearing examines a \$300 million contract to supply ammunition to the Afghan Security Forces. This contract is an important one because it relates directly to the success of our mission in Afghanistan. We know a lot about what went wrong after the contract to AEY was awarded in January 2007. We know that ammunition provided by AEY was unserviceable. We know that much of the ammunition was illegal, Chinese-made ammunition. We know that after paying AEY over \$60 million, the Army canceled the contract. And we know that last week the Justice Department indicted AEY and its top officials with 71 counts of fraud and related charges.

We have also learned that there are questions about the role of the U.S. Embassy in Albania in approving a plan to conceal the Chinese origins of AEY's ammunition. A letter I sent yesterday sought additional information about the Embassy's actions.

Today's hearing will examine what is not known: how did a company run by a 21-year-old president and a 25-year-old former masseur get a sensitive, \$300 million contract to supply ammunition to Afghan Forces?

My staff has prepared an analysis of the evidence that the committee has received, and I would like to ask unanimous consent that the staff analysis and the documents it cites be made part of today's hearing record.

Mr. DAVIS OF VIRGINIA. No objection.

Chairman WAXMAN. Without objection, that will be the order.
[The information referred to follows:]



UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
MAJORITY STAFF ANALYSIS
JUNE 24, 2008

THE AEY INVESTIGATION

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EXECUTIVE SUMMARY

On January 26, 2007, the U.S. Army awarded a \$300 million contract to supply ammunition to the Afghan Security Forces to AEY, Inc., a Florida company owned by 21-year-old Efraim Diveroli. On May 23, 2008, after payments of \$66 million, the Army terminated AEY's contract for cause. On June 19, 2008, a federal grand jury indicted AEY, Mr. Diveroli, and three other individuals affiliated with AEY on criminal charges arising from AEY's procurement of ammunition under the contract.

At the request of Chairman Henry A. Waxman, the Committee initiated an investigation to answer a basic question: Why did the federal government award a military contract worth \$300 million to a company run by an inexperienced 21-year-old? In the course of the investigation, the Committee has received to date 9,500 pages of documents from AEY, 14,000 pages from the Defense Department, and 2,600 pages from the State Department. The Committee staff also interviewed Army contracting officials who oversaw the contract, Defense and State Department contracting officials who oversaw other contracts with AEY, the State Department official in charge of its arms trafficker "watch list," and other individuals. This staff analysis summarizes the information received by the Committee.

The AEY contract can be viewed as a case study in what is wrong with the procurement process. The record before the Committee indicates that there was questionable need for the contract in the first place, a grossly inadequate assessment of AEY's qualifications, and poor execution and oversight of the contract. The result is that U.S. taxpayers have paid over \$66 million to a contractor who provided "unserviceable" ammunition, much of it apparently of illegal Chinese origin.

Questionable Need for Contract

When the Defense Department awarded the \$300 million ammunition contract to AEY in January 2007, the contract may have been unnecessary. There appear to have been several options available to the Defense Department to obtain the ammunition without cost to the taxpayer. At the time the AEY contract was awarded, the Eastern European countries from which AEY purchased its ammunition, such as Bosnia, Bulgaria, and Hungary, had offered to donate weapons and ammunition without charge. Albania, one of AEY's main suppliers, had been seeking ways to dispose of tons of stockpiled weapons and ammunition as a condition of gaining membership in NATO and the European Union. In fact, the President of Albania traveled to Iraq in December 2007 and made a personal offer to General David Petraeus and Ambassador Ryan Crocker to provide ammunition free of charge.

There is no evidence that the Defense Department considered the option of obtaining the ammunition supplied by AEY through donations, despite that fact that this could have saved U.S. taxpayers the cost of the contract.

Failure to Consult Arms Trafficker Watch List

When the Defense Department awarded the AEY contract in January 2007, all of the primary actors in the transaction — AEY and its president, AEY's middleman, and AEY's supplier — were listed on the State Department's watch list of potential arms traffickers. The State Department official in charge of the watch list described this as "a perfect trifecta."

Both AEY and its president, Efraim Diveroli, had been placed on the watch list in April 2006 because they were under investigation by U.S. Immigration and Customs Enforcement for "numerous violations of the Arms Export Control Act and contract fraud." The watch list warned that "future license applications involving Diveroli and/or his company should be very carefully scrutinized." The watch list also had entries for Heinrich Thomet, the president of Evdin, Ltd., a company based in Cyprus that acted as AEY's middleman; and Ylli Pinari, the head of the state-run Military Export Import Company (MEICO), which supplied the ammunition from Albania.

There is no evidence that the Defense Department checked the State Department watch list prior to executing the AEY contract.

Inadequate Assessment of Past Performance

Documents produced to the Committee show that federal agencies terminated, withdrew, or cancelled at least seven previous contracts with AEY, as well as four additional delivery orders under an eighth contract. Under these contracts, AEY provided potentially unsafe helmets to Iraq, failed to deliver at least 10,000 pistols to Iraq, and shipped poor quality ammunition to U.S. Special Forces. Government contracting officials repeatedly warned of "poor quality," "damaged goods," "junk" weapons, and other equipment in "the reject category," and they complained on several occasions that AEY was "hurting the mission" and had "endangered the performance" of government agencies.

One Defense Department contracting official interviewed by the Committee recalled that when AEY failed to deliver Beretta pistols for the Iraq Security Forces, Mr. Diveroli offered excuses that were false, such as blaming AEY's failure to perform on a hurricane in Florida that never occurred. A contracting official stated: "It's not like we didn't have the Internet in the Green Zone and couldn't check on this."

Based on a review of the documents, it appears that AEY's method of operation was to underbid competitors without a secured source for products, attempt to locate suppliers and goods after the contract award, and provide nonconforming substitute products when it was unable to locate goods required under the contract. One Defense Department official interviewed by the Committee called this a "bait and switch" tactic. When asked whether AEY was the worst company he encountered in Iraq, this contracting officer responded: "yeah, that was my lemon I had to make lemonade out of."

When the Defense Department was evaluating bidders for this \$300 million contract, a source selection team raised concerns with AEY's proposal, rating the company as

“Unsatisfactory” in its ability to conduct international shipments and manage subcontractors. But the Defense Department contracting officer who awarded the contract changed that rating to “Good” and also gave AEY an “Excellent” rating for quality and timeliness, stating that previous contracting officers “indicated no quality issues.” The contracting official concluded: “There is essentially no doubt that AEY would perform in accordance with the delivery schedules and has no history of quality related problems.”

Poor Execution and Oversight

When the Defense Department awarded its \$300 million contract to AEY, it failed to establish adequate standards for the age, quality, or shipping of the ammunition. The documents indicate that AEY took advantage of the inadequate standards, informing suppliers: “there is no age restriction for this requirement so please take that into consideration when you look around,” and “Please be advised, there is no age restriction for this contract!!!”

The Department also failed to monitor AEY’s performance adequately. The contracting officer told the Committee that the Defense Contract Management Agency did not conduct inspections of the AEY ammunition before it was shipped. Inspections were also overlooked in Afghanistan after the arrival of the ammunition.

When inspections did occur, they found serious problems in the quality of the ammunition being provided. Defense Department officials described shipments that showed “significant corrosion” and were “unserviceable.” They described crates that “disintegrated from extensive termite damage” and were “no longer safe for transportation.” In some cases, the ammunition was over 60 years old. After being reprimanded by the Defense Department, an AEY official acknowledged that the company had delivered “shit ammo” to the Afghan security forces.

Shipment of Illegal Chinese Ammunition

AEY appears to have violated federal law banning the acquisition of Chinese munitions. Kosta Trebicka, an Albanian businessman hired by AEY, told the Committee that his job was to remove ammunition from wooden crates with Chinese markings and repack it into cardboard boxes before shipment to Afghanistan. According to Mr. Trebicka, Mr. Diveroli asked him “if there were any Chinese writings on the top of the packaging or inside the metallic cans” and instructed him to “make sure no written papers get inside the carton boxes.” AEY, Mr. Diveroli, and three others now face criminal charges arising from the procurement of Chinese ammunition.

I. BACKGROUND

AEY, Inc., was founded by Michael Diveroli in 1999.¹ The company is located in Miami, Florida, and is run by Mr. Diveroli’s son, 22-year-old Efraim Diveroli, who serves as

¹ Florida Department of State, Division of Corporations, *Articles of Incorporation, AEY, Inc.* (Nov. 30, 1999) (online at www.sunbiz.org/search.html).

president of the company. Other company officials have included David Packouz, a 25-year-old former masseur, who served as vice president.

AEY received its first government contract in 2004. At that time, the company president, Efraim Diveroli, was 18 years old. The majority of AEY's contracts have been with the Defense Department or the State Department for the procurement of weapons, ammunition, or other military equipment. From 2004 through 2006, AEY received \$11 million in federal contracts, including \$2.4 million in contracts in 2006.²

AEY's largest government contract was awarded on January 26, 2007, by the U.S. Army to buy ammunition for the Afghan Security Forces.³ The contract had a value of \$298 million. It was awarded to fulfill a centerpiece of U.S. foreign policy: the effort to train and equip Afghan security forces so that U.S. troops could return home. At the time, company president Efraim Diveroli was 21-years-old.

Between the award of the contract on January 26, 2007, and the termination of the contract on May 23, 2008, AEY was paid \$66 million under the contract. At that time, AEY had received five task orders worth a total of \$155 million, but had failed to deliver on \$88 million of the ammunition it had committed to procure.⁴

On March 25, 2008, the Department of Defense suspended AEY from future contracting with any federal agency based on evidence that under the Afghan Security Forces contract, AEY illegally purchased ammunition in Albania that was "manufactured in the People's Republic of China between 1962 and 1974" and that AEY had made a "false or misleading" representation that some of this Chinese ammunition had been manufactured in Hungary.⁵ On May 23, 2008, after the Oversight Committee had scheduled a hearing relating to AEY, the Army terminated the contract for failure to deliver the ammunition in conformance with the terms and conditions of the contract.⁶ On June 19, 2008, a federal grand jury returned a 71-count indictment charging

² This data comes from the Eagle Eye Federal Prime Contracts Database, a federal procurement database application published by Eagle Eye, Inc. The database contains data from 1999 to 2008 that is compiled from the Federal Procurement Data System, the federal contract tracking system established by the General Services Administration. *See also*, USASpending.gov, *Database Search for AEY, Inc.* (FY 2000-2008) (online at www.usaspending.gov).

³ Procuring Contracting Officer, Source Selection Authority Decision Document for Request for Proposal W52P1J-06-R-0129: Non Standard Ammunition for Iraq (Jan. 22, 2007) (estimating AEY bid to be \$298,004,397); *\$298 M to AEY for Ammo in Afghanistan*, Defense Industry Daily (Mar. 21, 2007).

⁴ House Committee on Oversight and Government Reform, *Transcribed Interview of Kim M. Jones* (June 19, 2008).

⁵ Letter from Robert N. Kittel, Army Suspension and Debarment Official, to Efraim Diveroli, President, AEY, Inc. (Mar. 25, 2008).

⁶ Letter from Kim M. Jones, Procuring Contracting Officer, U.S. Army Sustainment Command, to Efraim Diveroli, President, AEY, Inc. (May 23, 2008).

AEY, Inc., Efraim Diveroli, David Packouz, and two other individuals associated with AEY with 35 counts of procurement fraud under 18 U.S.C. § 1031, 35 counts of making false statements to the U.S. Army relating to the country of origin of the ammunition under 18 U.S.C. § 1001, and one count of conspiracy under 18 U.S.C. § 371, all relating to AEY's procurement of Chinese ammunition under the Afghan Security Forces contract.⁷

Questions have also been raised about the involvement of the U.S. Embassy in Albania in AEY's activities. On June 23, Chairman Waxman sent a letter to Secretary of State Condoleezza Rice raising concerns about the role of the Embassy in concealing the Chinese origins of ammunition shipped by AEY to Afghanistan.⁸

II. THE COMMITTEE'S INVESTIGATION

On March 27, 2008, the *New York Times* published a long article describing AEY's procurement of "junk" ammunition under the Afghan Security Forces contract, its use of middlemen "suspected of illegal arms trafficking," and its use of illegal Chinese ammunition.⁹ The same day, Chairman Waxman opened an investigation to learn (1) "the scope of AEY's contracts" with the Defense Department, (2) the Department's efforts "to determine whether AEY is a responsible contractor," (3) the Department's "efforts to investigate" allegations of legal violations by AEY, and (4) actions taken against the company as a result of the investigation.¹⁰

In the course of the investigation, the Committee has received 9,500 pages of documents from AEY, 14,000 pages from the Defense Department, and 2,600 pages from the State Department. None of these entities has completed its document productions to date. The documents include contracts, certificates of conformance, correspondence between AEY and agencies, and internal e-mails and correspondence. The Defense Department did not produce the contract file for the Afghan Security Forces ammunition contract until June 23, 2008, even though the contracting officer informed Committee staff that she submitted it for production in early April.¹¹

The Committee staff has also interviewed Army contracting officials who oversaw the contract, Defense and State Department contracting officials who oversaw other contracts with

⁷ Indictment, *United States v. AEY, Inc. et al.*, S.D. Fla. (No. 08-20574) (June 19, 2008).

⁸ Letter from Henry A. Waxman, Chairman, to Condoleezza Rice, Secretary of State (June 23, 2008).

⁹ *Supplier Under Scrutiny on Aging Arms for Afghans*, New York Times (Mar. 27, 2008).

¹⁰ Letter from Henry A. Waxman, Chairman, to Robert M. Gates, Secretary of Defense (Mar. 27, 2008).

¹¹ House Committee on Oversight and Government Reform, *Transcribed Interview of Kim M. Jones* (June 19, 2008).

AEY, the State Department official in charge of its arms trafficker “watch list,” and other individuals.

This document is a staff analysis of the information received by the Committee. The evidence before the Committee shows that the AEY contract can be viewed as a case study of a dysfunctional procurement process. At nearly every turn, Defense Department officials made serious mistakes that have cost the taxpayers tens of millions of dollars. The documents and interviews show that there was a questionable need for the contract, an inadequate assessment of AEY’s qualifications, and poor execution and oversight of the contract.

III. QUESTIONABLE NEED FOR CONTRACT

One of the first questions a federal agency should ask before entering into a contract is whether a contract is necessary to obtain the good or services sought. In the case of AEY, it is unclear that there was a need for the \$300 million contract.

Because Afghanistan had previously used weapons designed for former Warsaw Pact nations, the Department of Defense made a determination to supply the Afghan security forces with ammunition for those types of weapons rather than providing new weapons and ammunition manufactured by U.S. companies.¹² This old Warsaw Pact ammunition is not difficult to obtain. In fact, some countries from which AEY procured ammunition have been actively seeking ways to give away or dispose of their munitions. For example, Bosnia, Bulgaria, and Hungary have offered their weapons and ammunition to Afghanistan as donations to help aid the war effort.¹³ The United States worked directly with Bosnia until 2004 to procure donations of weapons.¹⁴

Albania was a principal source for the ammunition provided under the AEY contract. When Albania sought membership in NATO and the European Union, both organizations imposed as a condition of entry the destruction of Albania’s stockpiled weapons and ammunition.¹⁵ As a result, Albania has been destroying ammunition similar to the ammunition

¹² Government Accountability Office, *Afghanistan Security: Efforts to Establish Army and Police Have Made Progress, but Future Plans Need to Be Better Defined* (June 2005) (GAO-05-575).

¹³ NATO, *Progress in Afghanistan: Bucharest Summit* (Apr. 2-4, 2008); Erwin Kauer, *Weapons Collection and Destruction Programmes in Bosnia and Herzegovina* (undated) (online at www.bmlv.gv.at/pdf_pool/publikationen/small_arms_weapons_collection_destruction_e_kauer.pdf).

¹⁴ *Bosnia’s Leftover Guns: Sell, Give, Destroy?*, Christian Science Monitor (July 10, 2006).

¹⁵ *The Munitions Challenges in Albania*, Journal of Mine Action (Spring 2000) (online at <http://maic.jmu.edu/Journal/4.1/munitions.htm>); EU Presidency Statement, *Small Arms and Light Weapons: Weapons Collection and Stockpile Management* (July 13, 2005) (online at www.europa-eu-un.org/articles/en/article_4912_en.htm).

that the Defense Department paid AEY to procure. To date, over 40,000 tons of ammunition has been destroyed in Albania, but as much as 85,000 tons remain.¹⁶

Like Bosnia, Bulgaria, and Hungary, Albania also offered to donate its ammunition without charge to U.S. taxpayers. The Committee has been informed that on December 23, 2007, the Albanian President and Defense Minister traveled to Iraq to meet with General David Petraeus, the commander of Multi-National Force-Iraq, and Ryan Crocker, the U.S. Ambassador to Iraq. According to Major Larry Harrison, the Chief of the Office of Defense Cooperation, he personally accompanied the Albanian officials on this trip and attended the meeting. Major Harrison informed Committee staff that the Albanian officials offered to donate the country's surplus ammunition to Afghanistan and Iraq.¹⁷

According to Major Harrison, General Petraeus rejected this offer because Albania was known to possess large quantities of Chinese munitions, which cannot be received under United States law.¹⁸

IV. FAILURE TO CONSULT ARMS TRAFFICKER WATCH LIST

At the time the Defense Department awarded AEY its \$300 million contract to procure ammunition for Afghanistan, the State Department's "watch list" for suspicious international arms dealers included entries for nearly everyone involved with the transaction, including AEY and its president, Efraim Diveroli; Heinrich Thomet, the head of Cyprus-based Evdin, Ltd., a company that acted as AEY's middleman; and Ylli Pinari, the head official of the Albanian state-run Military Export Import Company (MEICO), which was AEY's supplier. During a briefing with Committee staff, the State Department official in charge of the watch list described this as "a perfect trifecta."¹⁹

In 1968, Congress passed the Arms Export Control Act to require companies engaging in the brokering of weapons and ammunition to obtain a license for each transaction.²⁰ The State

¹⁶ See EOD Solutions, Ltd., *Demilitarisation Feasibility Study* (1999) (finding in excess of 125,000 tons of ammunition, 90% of which was over 30 years old); see also NATO Partnership for Peace, *Final Report on NATO PFP Trust Fund Project to Demilitarize Small Arms and Light Weapons in Albania* (May 2008) (noting that the Albanian Defense Ministry reported stockpiles of 100,000 tons of ammunition in 2001 and the subsequent destruction of 11,665 tons through NATO-led demilitarization programs).

¹⁷ Majority Staff, House Committee on Oversight and Government Reform, *Interview of Major Larry D. Harrison* (untranscribed) (Apr. 28, 2008).

¹⁸ *Id.*

¹⁹ Briefing by David C. Trimble, Director, Directorate of Defense Trade Controls, U.S. Department of State, to House Committee on Oversight and Government Reform (June 10, 2008).

²⁰ 22 U.S.C. § 2778.

Department's Directorate of Defense Trade Controls may deny or revoke licenses if it "deems such action to be in furtherance of world peace, the national security or the foreign policy of the United States, or is otherwise advisable."²¹ To help make these determinations, the State Department maintains a watch list of suspect individuals and entities based on information it receives from law enforcement, the intelligence community, and other government and non-governmental sources.²² For each license application, the Department checks this watch list for information about the applicant, its subcontractors, and other parties associated with the transaction, all of which must be identified.²³ The State Department may recommend that the license be allowed, disallowed, or returned without action because of defects in the application.²⁴

According to documents provided by the State Department in response to Committee requests, as of January 2007, all three entities involved in AEY's Defense Department contract — the purchaser, supplier, and middleman — were listed on the watch list.

Both AEY and its president, Efraim Diveroli, had been flagged by the State Department in April 2006 because they were under investigation by U.S. Immigration and Customs Enforcement (ICE).²⁵ According to an e-mail provided by the State Department, this investigation began in July 2005 and involved "numerous violations of the Arms Export Control Act and contract fraud."²⁶ ICE had described this investigation as involving "illegal firearms or firearm related transactions" by Efraim Diveroli and had therefore instructed U.S. officials encountering Efraim Diveroli to "[p]lease search luggage and photocopy any suspect documents."²⁷

On December 12, 2006, the State Department made the following entry to the watch list regarding both Mr. Diveroli and his company, AEY:

There appear to be several suspicious characteristics of this company, including the fact that Diveroli is only 21 years old and has brokered or completed several multi-million

²¹ International Traffic in Arms Regulations, 22 C.F.R. § 126.7.

²² Briefing by David C. Trimble, Director, Directorate of Defense Trade Controls, Department of State, to House Committee on Oversight and Government Reform (June 10, 2008).

²³ *Id.*

²⁴ *Id.*; see also International Traffic in Arms Regulations, 22 C.F.R. § 129.7(d).

²⁵ AEY, Inc., License Registration, Department of State, Office of Defense Trade Controls (Apr. 4, 2006).

²⁶ E-mail from Michael C. Mentavlos to Michael C. Mentavlos (Oct. 9, 2007).

²⁷ U.S. Immigration and Customs Enforcement, *Tech II – Person Subject Display of Efraim Diveroli* (accessed on Aug. 14, 2006).

dollar deals involving fully and semi-automatic assault rifles. Future license applications involving Diveroli and/or his company should be very carefully scrutinized.²⁸

AEY's middleman in this transaction was Evdin, Ltd., a Cyprus-based company, which reportedly purchased ammunition from Eastern European countries and sold it to AEY. The State Department placed the president of Evdin, Ltd., Heinrich Thomet, on the watch list on August 22, 2006. According to the watch list entry, the reasons for listing Mr. Thomet were described only in classified documents issued by the Central Intelligence Agency and the Defense Intelligence Agency.²⁹ AEY's business relationship with Evdin extended over multiple transactions. In responding to an August 2007 solicitation from AEY, Evdin noted that there was "a long lasting and strong relationship between EVDIN Limited and AEY Inc."³⁰

The Albanian source for the ammunition was the state-run Military Export-Import Company (MEICO), which was headed by Ylli Pinari.³¹ The State Department placed Mr. Pinari on the watch list on November 14, 2005, also based on reasons described only in classified documents.³²

In addition to entities related to AEY's Defense Department contract to buy ammunition for Afghanistan, the State Department watch list also contained entries for individuals and companies associated with AEY under other contracts with the U.S. government. For example, in 2006, AEY entered into a Defense Department subcontract with Imex Group, Ltd., to provide ammunition to the Iraq Security Forces.³³ Imex is run by Petr Bernatik, a Czech national, who had been placed on the watch list on September 29, 2004, for reasons based on classified information.³⁴ According to the State Department, the current unclassified watch list entry for Mr. Bernatik states: "Identified arms trafficker in Czech Republic – should be denied."³⁵

Checking the State Department arms trafficking watch list would seem to be a basic precaution to take before awarding a company a \$300 million contract to supply ammunition overseas. In the case of AEY, this step was not taken, apparently because AEY did not apply for

²⁸ U.S. Department of State, Directorate of Defense Trade Controls, *Microsoft Access Database Entry for AEY, Inc., Update Watch List Detail* (accessed May 6, 2008).

²⁹ U.S. Department of State, Directorate of Defense Trade Controls, *Watch List Search of Heinrich Thomet* (Feb. 6, 1991 to Present) (accessed May 6, 2008).

³⁰ Letter from Evdin, Ltd. to AEY, Inc. (Aug. 13, 2007).

³¹ *See Albania Sells Off its Military Hardware*, BBC News (Apr. 17, 2002); *Supplier Under Scrutiny on Aging Arms for Afghans*, New York Times (Mar. 27, 2008).

³² U.S. Department of State, Directorate of Defense Trade Controls, *Watch List Search of Ylli Pinari* (Feb. 6, 1991 to Present) (accessed May 6, 2008).

³³ *Contract between AEY, Inc. and Imex Group Ltd.* (2006).

³⁴ U.S. Department of State, Directorate of Defense Trade Controls, *Watch List Search of Petr Bernatik* (Feb. 6, 1991 to Present) (accessed May 6, 2008).

³⁵ *Id.*

a broker's license and because the Defense Department did not require one. The Defense Department contracting official who awarded the AEY contract told the Committee that she was not aware of the existence of the watch list and did not inquire with the State Department regarding potential watch list entries prior to the award.³⁶ She acknowledged, however, that it "may be useful" to arrange for a check of the watch list for contracts for nonstandard ammunition.³⁷

V. INADEQUATE ASSESSMENT OF AEY'S PAST PERFORMANCE

The evidence before the Committee indicates that the Defense Department's review of AEY's past performance was inadequate. By the time the \$300 million contract to AEY was awarded, the company had accumulated a long record of failed and dubious performance under other Defense Department and State Department contracts. This record was overlooked by contracting officials who awarded the contract to AEY.

A. AEY's Performance under Other Defense Department Contracts

Documents obtained by the Committee show that AEY's performance on other Defense Department contracts was poor. Under these contracts, AEY provided potentially unsafe helmets to Iraq, failed to deliver at least 10,000 pistols to Iraq, and shipped poor quality ammunition to U.S. Special Forces. In all, the Defense Department has terminated at least five previous contracts with AEY due to the company's failure to perform adequately.³⁸ Additionally, the Defense Department had terminated four delivery orders under a separate contract.³⁹

In October 2005, AEY delivered a shipment of damaged helmets to the Multi-National Security Transition Command-Iraq (MNSTC-I). A U.S. inspector who examined the shipment wrote:

³⁶ House Committee on Oversight and Government Reform, *Transcribed Interview of Melanie A. Johnson* (June 18, 2008).

³⁷ *Id.*

³⁸ U.S. Department of Defense, *AEY, Inc. Contract H92239-05-T-0010* (Feb. 25, 2005); U.S. Department of Defense, *AEY Inc. Contract W911RX-05-P-0267* (Sept. 27, 2005); U.S. Department of Defense, *AEY, Inc. Contract W911RX-05-P-0284* (Sept. 30, 2005); U.S. Department of Defense, *AEY Inc. Contract H92239-05-P-0034* (date unknown); U.S. Department of Defense, *AEY Inc. Contract W9124Q-06-P-0493* (Sept. 29, 2006).

³⁹ U.S. Department of Defense, *AEY Inc. Contract W914NS-05-D-9012* (Apr. 25, 2005).

The helmets came to Abu Ghraib by mistake. They are not very good. They have peeling paint and a few appear to have been damaged such as having been dropped. When I first saw them, I put them in the reject category.⁴⁰

The same inspector later wrote to AEY about the helmets:

Some people at MNSTC-I got a little wound up when they saw the daily receiving report. They remembered the 10,000 helmets you sold them earlier this year and the junk AKs we still have in the warehouse. The concern was that, if they break and crack, are they ballistically correct? In other words, will they stop a bullet and what do we do if they don't? Several scenarios were being planned for you, none of them pleasant.⁴¹

Another MNSTC-I official was more blunt, writing: "Bottom line, the helmets are damaged goods and we don't want them."⁴²

During an interview with Committee staff, the contracting officer for the helmet contract stated that AEY failed to provide proof that the helmets were safe. Instead, AEY submitted a document written in Chinese that did not reference the proper safety standards and "didn't even look like it ... matched up" with the shipment of helmets.⁴³ The contracting officer told the Committee that AEY was "nonperforming" on this contract and that he had a "particular issue" with Mr. Diveroli, explaining: "I just don't trust the guy."⁴⁴

In late 2005, AEY failed to deliver more than 10,000 Beretta pistols under a \$5.6 million delivery order under a larger contract to supply the Iraq Security Forces. The contracting officer overseeing this contract pressed AEY to deliver the goods, writing: "I need immediate resolution on all outstanding 9 mm pistols. ... we are running critically low with inventory."⁴⁵ He subsequently concluded that Mr. Diveroli had provided a series of false excuses for failing to deliver. These excuses included claims that a plane crash destroyed key documents, that the German government was interfering with the delivery of Italian pistols, and that a hurricane hit Miami, Florida, where AEY is located, depriving Mr. Diveroli of water and making "his life ...

⁴⁰ E-mail from Richard Emmert, Quality Assurance Representative, Defense Contract Management Agency, to Lieutenant Commander Frank Futcher, Contracting Officer, Joint Contracting Command Iraq/Afghanistan, *et al.* (Oct. 16, 2005).

⁴¹ E-mail from Richard Emmert, Quality Assurance Representative, Defense Contract Management Agency, to Efraim Diveroli, President, AEY, Inc. (undated).

⁴² E-mail from Andrew Griffith, Multi-National Security Transition Command – Iraq, to Richard Emmert, Quality Assurance Representative, Defense Contract Management Agency, *et al.* (Oct. 18, 2005).

⁴³ House Committee on Oversight and Government Reform, *Transcribed Interview of Commander Frank Futcher* (June 13, 2008).

⁴⁴ *Id.*

⁴⁵ E-mail from Commander Robert Brooks, Joint Contracting Command-Iraq/Afghanistan, to Efraim Diveroli, President, AEY, Inc. (undated).

just terrible.”⁴⁶ According to another contracting official: “[W]e could tell there was no hurricane in Miami. It wasn’t like we didn’t have the Internet in the Green Zone.”⁴⁷

After months of delays, the contracting officer concluded, “I couldn’t take anything [Mr. Diveroli] said credibly,” and he terminated the contract for cause.⁴⁸ He explained to the Committee:

All his reasons continued to build and build. And then it just got to the point where it was the straw on the camel’s back. And I said, look, no amount of consideration on your contracts to get these delivered are going to take care of the fact that you have been unable to deliver. You have not had one delivery order come in.⁴⁹

The contracting officer also terminated AEY’s remaining delivery orders under the contract and declined to allow AEY to compete for future delivery orders under another contract for Iraq work.⁵⁰ He told the Committee that AEY repeatedly engaged in “bait and switch” tactics by substituting nonconforming goods in place of those required by the contract. He concluded that AEY’s performance was “extremely poor.” When asked whether AEY was the worst company he dealt with in Iraq, he responded: “Yes, they were. ... AEY, yeah, that was my lemon I had to make lemonade out of.”⁵¹

AEY also performed poorly on past contracts for ammunition, including the same type of ammunition AEY later delivered to Afghanistan. In April 2005, U.S. Army Special Operations Command (USASOC) partially terminated an ammunition contract with AEY because the company “failed to deliver acceptable goods,” “provided no notice of an excusable delay,” and “provide[d] inadequate assurance of future performance.”⁵² A few weeks later, USASOC partially terminated a second ammunition contract due to “failure to deliver acceptable goods.”⁵³

⁴⁶ House Committee on Oversight and Government Reform, *Transcribed Interview of Commander Robert Brooks* (June 13, 2008); House Committee on Oversight and Government Reform, *Transcribed Interview of Commander Frank Fletcher* (June 13, 2008).

⁴⁷ House Committee on Oversight and Government Reform, *Transcribed Interview of Commander Frank Fletcher* (June 13, 2008).

⁴⁸ House Committee on Oversight and Government Reform, *Transcribed Interview of Commander Robert Brooks* (June 13, 2008).

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² U.S. Department of Defense, *Amendment of Solicitation/Modification of Contract No. H92239-05-P0072* (Apr. 4, 2005).

⁵³ E-mail from Major Michael Taylor, Contracting Officer, U.S. Army Special Operations Command, to Efraim Diveroli, President, AEY, Inc. (Apr. 26, 2005).

Defense Department documents show that AEY delivered a type of ammunition that “was second-generation reloaded ammunition, and is not acceptable by military standards.”⁵⁴ The ammunition had burn marks, corrosion, and defects so serious that “if fired pressure could buildup [and] cause the weapons systems to malfunction.”⁵⁵ Rather than correct the defective ammunition, AEY blamed the ammunition inspector, calling her “extremely irritable” and accusing her of “foul play.”⁵⁶

In the two years preceding the award of the Afghanistan contract, AEY experienced a number of other performance problems:

- On December 1, 2006, less than two months prior to the Afghanistan award, the Army terminated an AEY contract for cause after the company failed to deliver 150 mounts for gun scopes. After initially falling behind on deliveries, Mr. Diveroli pleaded with the contract officer not to cancel the contract, writing: “if God Forbid we were to have our contract terminated this would be devastating and possibly crippling to us as a very small business concern.”⁵⁷ When AEY failed to deliver the gun mounts after the Army granted two additional extensions, the contract was terminated.⁵⁸
- In February 2006, AEY failed to deliver “J-Point Scopes” under an Army contract. The contract was terminated for cause.⁵⁹ The contracting official wrote that after initial delays, he had given AEY the benefit of the doubt because it was a small business. AEY then sent a “sample” product that was rejected as “cheap copies of an actual patented J-Point system.”⁶⁰ After repeatedly receiving “excuses and invalid reasons” for AEY’s failure to deliver, he realized the Army “was being strung along by a vendor who knew he was not able to perform,” and he terminated the contract for default.⁶¹

⁵⁴ Memorandum from Richard McArdle, Chief, Plans and Operations, U.S. Army Special Operations Command, to USASOC Contracting Office (Apr. 5, 2005).

⁵⁵ *Id.*

⁵⁶ E-mail from Efraim Diveroli, President, AEY, Inc., to U.S. Army Special Operations Command (Apr. 5, 2005).

⁵⁷ Letter from Efraim Diveroli, President, AEY, Inc., to Jesse Brennan, Contracting Officer, Army Contracting Agency (undated).

⁵⁸ Letter from Jesse Brennan, Contracting Officer, Army Contracting Agency, to Efraim Diveroli, President, AEY, Inc. (Dec. 1, 2006).

⁵⁹ E-mail from Donald Peters, Contract Specialist, Army Contracting Agency, to Efraim Diveroli, President, AEY, Inc. (undated).

⁶⁰ U.S. Department of Defense, *AEY, Inc. Contract W991RX-05-P-0267* (Sept. 27, 2005); E-mail from Major Kim D. Zimmerman to Donald W. Peters (Jan. 12, 2006).

⁶¹ Declaration of Donald W. Peters, Contract Specialist, *Bid Protest (Docket No. 55346)* (Mar. 6, 2006).

- In August 2005, AEY failed to deliver machine guns and pistols to Iraq. In an e-mail obtained by the Committee, the contracting official demanded an explanation for the delay, writing that “over TWO months have elapsed without delivery of the order.”⁶²

B. AEY’s Performance under State Department Contracts

AEY also had a history of poor performance of providing munitions and other equipment under contracts and purchase orders with the State Department. As a result, the State Department has terminated or cancelled two contracts due to AEY’s inability to perform.⁶³

For example, under a 2006 contract for field equipment for the U.S. Embassy in Colombia, AEY provided the wrong model of laser pointers and rifle attachments as required under the solicitation.⁶⁴ In addition, AEY failed to obtain the proper export license for the goods and could not meet the required shipping date.⁶⁵ AEY also attempted to provide unacceptable substitute goods under this contract without notifying the Department.⁶⁶ In a November 1, 2006, memo, a State Department official noted:

The manufacturer of the product AEY quoted contacted [the Department] to inform us that AEY is not an approved distributor and will not be able to provide the products quoted to Bogota. ... In response, AEY provided information on totally different products by totally different manufacturers. ... All are concerned that if AEY were not questioned, AEY would have provided different products without State’s knowledge. Now State knows AEY plans to provide products untested. ... Is this considered “bait and switch”?⁶⁷

The State Department canceled this order November 2, 2006.⁶⁸

⁶² E-mail from Vance Jochim, Department of State End State Task Force and Iraq Commission on Public Integrity, to Efraim Diveroli, President, AEY, Inc., *et al.* (Aug. 30, 2005).

⁶³ U.S. Department of State, *AEY Inc. Contract SAQMPD-06-M-3245* (Sept. 30, 2006); U.S. Department of State, *AEY Inc. Contract SAQMPD-06-M-3139* (Feb. 1, 2007).

⁶⁴ U.S. Department of Defense, *AEY, Inc. Contract SAQMPD06M3246* (Sept. 30, 2005); E-mail from Kevin Higgins, Technical Advisor, to Timothy E. Henderson, and Suzanne T. Sharp, Contract Specialist (Oct. 25, 2006).

⁶⁵ E-mail from Timothy Henderson to Suzanne T. Sharp, Contract Specialist (Oct. 24, 2006).

⁶⁶ Memorandum from Vincent J. Chaverini, Jr., Contracting Officer, to Dennis Gallagher, Legal Advisor (Nov. 1, 2006).

⁶⁷ *Id.*

⁶⁸ E-mail from Suzanne T. Sharp, Contract Specialist, to Efraim Diveroli, President, AEY, Inc. (Nov. 2, 2006); letter from Vincent J. Chaverini, Jr., Contracting Officer, to Efraim Diveroli, President, AEY, Inc. (Nov. 2, 2006).

Under a 2006 contract with the State Department to deliver holographic weapons systems with night vision scopes to the U.S. Embassy in Colombia, AEY failed to deliver the goods by the deadline because the manufacturer would not sell to them.⁶⁹ Again, AEY offered a substitute.⁷⁰ The contracting officer rejected AEY's proposal, stating: "you were awarded subject order based on the product you proposed via fedbid auction thus you are hereby directed to comply."⁷¹ AEY failed to deliver any equipment under this contract, and on March 1, 2007, the contract was "terminated for cause" because the weapon system was not delivered "in a timely manner."⁷²

Under a 2005 contract for tactical equipment for use in Iraq, including optical sights and weapons adaptors, AEY repeatedly ignored a contracting officer's explicit warnings that only the exact products under the contract would be accepted.⁷³ AEY delivered only one item by the April 18, 2005, delivery date, and it was rejected as nonconforming.⁷⁴ The contracting officer wrote to Mr. Diveroli: "I 'Needed' this equipment by 4/18. So the fact that I still do not have it is hurting the mission."⁷⁵ The State Department withdrew its order and obtained much of the equipment from other vendors. In a letter to AEY, the contracting officer wrote:

You are hereby notified that your failure to deliver the below listed items on April 18, 2005 as stated and in accordance with subject has endangered the performance of the Department of State mission. Further, in subsequent correspondence your promises of delivery have not been met. You are hereby informed that the undelivered items are

⁶⁹ U.S. Department of State, *AEY, Inc. Contract SAQMPD-06-M3139* (Sept. 28, 2006); E-mail from Patrick Fulya, Account Manager, to Doug Stuck, FedBid (May 11, 2007).

⁷⁰ Memorandum from Dennis J. Gallagher, Legal Advisor, to Benita D. Williams, Contracting Officer (Jan. 19, 2007).

⁷¹ E-mail from Benita D. Williams, Contracting Officer, to Efraim Diveroli, President, AEY, Inc. (Feb. 15, 2007).

⁷² Letter from Benita D. Williams, Contracting Officer, to Efraim Diveroli, President, AEY, Inc. (Mar. 1, 2007).

⁷³ U.S. Department of State, *AEY, Inc. Contract SAQMPD-05-M-1722* (Apr. 14, 2005); *see, e.g.*, E-mail from Amy Maroney, Weapons Program Coordinator, to Efraim Diveroli, President, AEY, Inc. (Apr. 18, 2005); E-mail from Amy Maroney, Weapons Program Coordinator, to Efraim Diveroli, President, AEY, Inc. (undated); E-mail from Amy Maroney, Weapons Program Coordinator, to Efraim Diveroli, President, AEY, Inc. (Apr. 15, 2005).

⁷⁴ E-mail from Randarda R. Mathis, Weapons Program Coordinator, to Benita Williams, Contracting Officer (undated).

⁷⁵ E-mail from Amy Maroney, Weapons Program Coordinator, to Efraim Diveroli, President, AEY, Inc. (Apr. 20, 2005).

being withdrawn from subject order. The DoS mission can no longer be delayed due to your inability to produce the items as stated in subject order.⁷⁶

Also in 2005, AEY offered nonconforming substitute carbines on three separate but related contracts. The State Department's contracting officers warned AEY repeatedly that the "product requested is for a purpose, and no substitutes will be accepted."⁷⁷ After the State Department rejected the weapons offered by AEY in October 2005, it modified the contracts by reducing the price and extending the delivery date, only to have AEY deliver additional nonconforming goods.⁷⁸

In 2006, AEY again offered nonconforming goods on a contract for rail adaptor systems, leading a State Department official to complain that AEY should provide the specific part that the State Department requested rather than "what the vendor is trying to convince us to use."⁷⁹ One State Department official wrote to a colleague: "We have had problem[s] with AEY in the past."⁸⁰

C. The Defense Department's Evaluation of AEY's Past Performance

The Defense Department's "source selection team" for the \$300 million Afghan ammunition contract evaluated AEY's past performance based only on three contracts identified by AEY.⁸¹ A review of a database available to the source selection team would have identified the other Defense and State Department contracts awarded to AEY.⁸² Apparently, however, AEY's performance under other contracts with the Departments of Defense and State was not considered.

⁷⁶ Letter from Benita D. Williams, Contracting Officer, to Efraim Diveroli, President, AEY, Inc. (May 25, 2005).

⁷⁷ E-mail from Nigel McKenzie to Efraim Diveroli, President, AEY, Inc. (Oct. 26, 2005).

⁷⁸ E-mail from Kenneth J. Beaudoin to Nigel A. McKenzie (Oct. 31, 2005); E-mail from Steven R. Frazer, Branch Chief, Mobile Antiterrorist Training Team, to Patrick Villegoueix-Ritaud, Functional Analyst IV and Coordinator Diplomatic Security (Jan. 19, 2006); E-mail from Nigel A. McKenzie to James Hopkinson, Kwan Chun and Troy Shirley (Mar. 28, 2006).

⁷⁹ E-mail from Diane E. Toledo-Gaskins, Procurement Specialist, to Russell Dickinson, Weapons Program Officer (Oct. 11, 2006).

⁸⁰ E-mail from Russell Dickinson, Weapons Program Officer, to Laverne G. Jones, Contracting Officer (Oct. 11, 2006).

⁸¹ Procuring Contracting Officer, *Source Selection Authority Decision Document for Request for Proposal W52PIJ-06-R-0129: Non Standard Ammunition for Iraq* (Jan. 22, 2007).

⁸² The Federal Procurement Data System identifies over 90 contracts awarded to AEY prior to January 2007. Information on these contracts was available through the database at the time the \$300 million Afghan ammunition contract was awarded.

The source selection team considered AEY's record of (1) on-time delivery, (2) quality, (3) international movement of ammunition, and (4) success as a "system integrator," which included experience in "the identification of ammunition appropriate for foreign weapon systems," "the ability to establish quality control, safety, and transportation plans," and "adhering to the regulations and policies of both foreign and U.S. Governments."⁸³ The team gave AEY a mixed rating.

The source selection team rated AEY's past history of on-time delivery and quality as "Excellent." The contracting officer who reviewed the source selection team's evaluation agreed, concluding:

There essentially is no doubt that AEY would perform in accordance with the delivery schedules and has no history of quality related problems. Based on this, AEY's initial rating was "Excellent."⁸⁴

With respect to AEY's history of "international movement" and experience as a "systems integrator," the source selection team concluded that AEY's past performance was "Unsatisfactory." The team found that the contracts submitted by AEY for consideration failed to demonstrate "past performance experience with contracts for large number of varied items and the ability to identify appropriate ammunition to stated foreign weapon systems." The team concluded: "Lacking this experience, there is substantial doubt that AEY could perform in accordance with the solicitation requirements."⁸⁵

After being notified of its unsatisfactory rating, AEY submitted additional information about one contract. The additional information did not change the view of the source selection team, which continued to rate the company's experience as "Unsatisfactory."⁸⁶

On January 22, 2007, the contracting official who ultimately awarded the contract overruled the source selection team and raised AEY's score from "Unsatisfactory" to "Good." During an interview with Committee staff, she stated that she disagreed with the source selection team's conclusion that the contract reviewed was insufficient evidence of prior experience in these categories.⁸⁷ She acknowledged that her change made "a difference," and she stated that AEY "would not [have] gotten the award" without this adjustment.⁸⁸ In changing the rating,

⁸³ Procuring Contracting Officer, *Source Selection Authority Decision Document for Request for Proposal W52PIJ-06-R-0129: Non Standard Ammunition for Iraq* (Jan. 22, 2007).

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Id.*; House Committee on Oversight and Government Reform, *Transcribed Interview of Melanie A. Johnson* (June 18, 2008).

⁸⁷ House Committee on Oversight and Government Reform, *Transcribed Interview of Melanie A. Johnson* (June 18, 2008).

⁸⁸ *Id.*

however, she had gathered no additional information about these contracts beyond what was available to the source selection team.⁸⁹

Even given the limited universe of contracts considered by the contracting officer, it is difficult to understand why AEY was rated “Excellent” for on-time delivery and quality and “Good” for experience in international movement and systems integration. One of the three contracts reviewed was AEY’s contract to supply munitions to the Iraq Security Forces, including 10,000 Beretta pistols. As discussed above, this pistol delivery order was terminated for cause, with the contracting officer who terminated it stating that AEY’s performance had been “extremely poor” and that AEY was the worst contractor he dealt with in Iraq.

When the Committee asked the contracting official why she concluded that AEY had “no history of quality related problems,” she explained that she obtained her information from a different official who was not familiar with AEY’s poor performance. She acknowledged: “If I would have been aware of that information, it would have entered into the decision.”⁹⁰

D. AEY’s Possible Concealment of Contract Terminations

In order to compete for a Defense Department contract, AEY was required to complete and submit a federal form called an Online Certifications and Representations Application (ORCA), which contains questions about the company, its activities, and its contracting history.⁹¹ AEY submitted this form for 2005, 2006, and 2007. On each ORCA form, AEY certified that it “has not, within a three-year period preceding this offer, had one or more contracts terminated for default by any Federal agency.”⁹²

Documents provided to the Committee identify at least eleven AEY contracts and delivery orders that were terminated because AEY failed to perform adequately, including at least three that were officially terminated for default. These include two contracts the Defense Department terminated in 2006 and another contract the State Department terminated in 2007.⁹³

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ U.S. Department of Defense, *AEY, Inc. Contract W52PIJ-07-0004*, Amendment 1 (Jan. 26, 2007).

⁹² AEY, Inc., *Online Representations and Certification Application* § 52.209-5 (June 17, 2005) (valid through June 17, 2006); AEY, Inc., *Online Representations and Certifications Application* § 52.209-5 (July 25, 2006) (valid through July 2, 2007); AEY, Inc., *Online Representations and Certification Application* § 52.209-5 (July 2, 2006) (valid through July 2, 2008).

⁹³ Settlement Agreement, Appeal of AEY, Inc. Under Contract Nos. W911RX-05-P-0284 and W911RX-05-P-0267, Armed Services Board of Contract Appeals No. 55346 and 55363 (Mar. 17, 2006); U.S. Department of State, *AEY, Inc. Contract SAQMPD-06-M-3139* (Sept. 28, 2006).

According to the Army contracting official who awarded the Afghanistan ammunition contract, if AEY's ORCA form had listed these contract terminations, it "may have" affected the decision.⁹⁴

The failure of AEY to report its prior terminations may be a criminal false statement. The ORCA form explicitly states that "a false, fictitious, or fraudulent certification may render the maker subject to prosecution" under the federal false statements statute, 18 U.S.C. § 1001, a crime punishable by up to five years of imprisonment.⁹⁵

VI. POOR CONTRACT EXECUTION AND OVERSIGHT

In the contract awarded to AEY in January 2007 to supply ammunition to Afghan security forces, the Defense Department provided little or no guidance on the quality or condition of the ammunition required. The contract called for ammunition that was "serviceable," but it gave no further details.⁹⁶ The contract also specifically permitted the use of "surplus" ammunition.⁹⁷ The contract failed to set an age limit for the ammunition purchased by AEY. A section of the contract in which the contracting officer answered questions raised by bidders addressed this issue specifically:

Question 2: Is there an age limitation on the items to be delivered under this contract?

Answer: No, but material must be serviceable and issuable to all units without qualifications.⁹⁸

Despite the hazardous nature of the cargo, the contract also had no specific restrictions on the type of packaging to be used in transporting ammunition. The contract had the following instruction, without any elaboration: "Package in cartons in accordance with the best commercial practice for international shipment."⁹⁹

The record does not adequately explain why the Defense Department failed to include proper quality, age, and packaging requirements in the contract. Other military contracts for similar ammunition included such restrictions.¹⁰⁰ For example, contracts to obtain nonstandard

⁹⁴ House Committee on Oversight and Government Reform, *Transcribed Interview of Melanie A. Johnson* (June 18, 2008).

⁹⁵ AEY, Inc., Online Representations and Certifications Application § 52.209-5 (Sept. 25, 2006) (valid through Sept. 5, 2007).

⁹⁶ U.S. Department of Defense, *AEY, Inc. Contract W52P1J-07-0004* (Jan. 26, 2007).

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ Briefing by Lieutenant General William Mortensen, Deputy Commander, U.S. Army Materiel Command, to House Committee on Oversight and Government Reform (Apr. 11,

ammunition for use by the Iraq Security Forces typically include a restriction that the ammunition be 20 years old or newer.¹⁰¹

Documents obtained by the Committee show that AEY paid close attention to age restrictions in contracts, including the Afghanistan ammunition contract, and sought to take advantage of the lack of such restrictions in order to obtain older, cheaper ammunition. In one request for price quotes under the Afghanistan contract, AEY wrote to potential suppliers, “there is no age restriction for this requirement so please take that into consideration when you look around.”¹⁰² In another request for ammunition for Afghanistan, AEY wrote, “Please be advised, there is no age restriction for this contract!!!”¹⁰³ In a third request, AEY noted, “We remind you that although target prices seem low, we already have the contract with the US Government signed ... and ANY age ammunition is acceptable.”¹⁰⁴

In July 2007, when a restriction requiring ammunition less than 20 years old was relaxed on a different ammunition contract, an AEY employee wrote on the document: “Wonderful!”¹⁰⁵

As a result of the lack of appropriate specifications, much of the ammunition AEY provided under the Afghanistan contract was 40, 50, or even 60 years old. AEY purchased ammunition from Bulgaria that had been manufactured as early as 1944.¹⁰⁶ It bought ammunition from Slovakia that was produced in 1956.¹⁰⁷

AEY also took advantage of the Defense Department’s failure to conduct rigorous inspections. According to the contracting officer, the Defense Contract Management Agency did not conduct consistent inspections of AEY’s ammunition before it was shipped, citing “a plethora of reasons,” including an inability to send inspectors to the various Eastern European countries from which AEY procured ammunition.¹⁰⁸ In Afghanistan, both DCMA and the

2008); House Committee on Oversight and Government Reform, *Transcribed Interview of Melanie A. Johnson* (June 18, 2008).

¹⁰¹ House Committee on Oversight and Government Reform, *Transcribed Interview of Melanie A. Johnson* (June 18, 2008).

¹⁰² AEY, Inc., Request for Quotation for Munitions (undated) (emphasis in original).

¹⁰³ AEY, Inc., Request for Quotation for Munitions (undated).

¹⁰⁴ E-mail from Efraim Diveroli, President, AEY, Inc., to “Amit,” *et al.* (undated).

¹⁰⁵ U.S. Department of Defense, Solicitation W52P1J-07-R-0104, Amendment 2 (July 18, 2007).

¹⁰⁶ *Contract between AEY, Inc. and Arcus Co.* (Nov. 11, 2007).

¹⁰⁷ E-mail from Efraim Diveroli, President, AEY, Inc., to Vladimir Duris, ZVS Holding (Nov. 21, 2007).

¹⁰⁸ House Committee on Oversight and Government Reform, *Transcribed Interview of Kim M. Jones* (June 19, 2008).

Combined Security Transition Command–Afghanistan (CSTC-A) took the position that because of resource limitations “100 percent inspection” of ammunition shipments was not possible.¹⁰⁹

When military officials did conduct inspections, they discovered serious problems with the ammunition AEY delivered. For example, in one report obtained by the Committee, a Defense Department official described the quality of a shipment of ammunition on March 10, 2008:

Initial inspection showed that significant corrosion, rust and an oily material was evident on the ammunition; CSTC-A ammunition representatives reporting ammo is unserviceable. Munitions from this shipment are judged to be barely within limits of safe storage and transportation.¹¹⁰

The Defense Department official also noted that the ammunition was not properly labeled or categorized:

Ammunition was sent in mislabeled ammunition boxes. ... Because a majority of the boxes were mis-labeled, we have no confidence for what is in each box. Every box has to be opened, identified and counted. Several boxes are just a pile of loose rounds. Also, documentation is missing. There were no packing slips, hazardous declaration, nor invoice attached to the pallets of ammunition.¹¹¹

In another report, dated February 28, 2008, the same Defense Department official described how AEY’s packaging was so poor that a shipment of ammunition could not be unloaded from the airplane:

During aircraft movement, three crates disintegrated from extensive termite damage to the wood. Two skids containing fuses show significant damage to packaging crates and termite infestation. An additional skid carrying fuses showed damage from ground-handling movement prior to arrival/delivery at Kabul Intl Airport. Seven wooden crates contained on one skid disintegrated when removed from the aircraft by ground handlers due to significant termite damage. Significant external water and rust damage to metal fuse casings. ... Munitions from this shipment are no longer safe for transportation.¹¹²

On March 18, 2008, the Army sent a letter to AEY stating that its ammunition “has been found to be unacceptable” and demanding that AEY fix the problems.¹¹³ In an e-mail sent the

¹⁰⁹ *Id.*

¹¹⁰ AEY, Inc., Certificate of Conformance (No. AFG-002-63) (Feb. 29, 2008) (CSTC-A certification statement dated Mar. 10, 2008).

¹¹¹ *Id.*

¹¹² AEY, Inc., Certificate of Conformance (No. AFG-0004-10) (Feb. 19, 2008) (CSTC-A certification statement dated Feb. 28, 2008).

¹¹³ Letter from Kim M. Jones, Contracting Officer, U.S. Army Sustainment Command, to Efraim Diveroli, President, AEY, Inc. (Mar. 18, 2008).

same day, an AEY employee privately acknowledged that the company had delivered “shit ammo” to Afghanistan.¹¹⁴

AEY also failed to deliver ammunition on time. A January 8, 2008, letter from the Army stated that AEY was four months late on the shipment of nearly two million rounds of ammunition, and eight months late on the shipment of another three million rounds.¹¹⁵ In a letter to the Army, AEY blamed its delays on subcontractors and bureaucratic mix-ups, writing:

Unfortunately, several key deals AEY has relied on, have either fell through or suffered serious discrepancies and delays with vendors who are unable to stand by their original commitment, by means of licensing, documentation, and availability.¹¹⁶

According to the contracting officer, AEY provided a variety of excuses for its late deliveries, including a supplier who “breached the contract and sold their ammunition to someone else,” “substandard stock,” and “the changing price of the Euro.”¹¹⁷

VII. USE OF CHINESE AMMUNITION AND OTHER GOODS

American contractors are prohibited from obtaining weapons or ammunition manufactured in the People’s Republic of China. The Defense Federal Acquisition Regulation Supplement states:

Any supplies or services covered by the United States Munitions List that are delivered under this contract may not be acquired, directly or indirectly, from a Communist Chinese military company.¹¹⁸

The Defense Department solicitation for the \$300 million ammunition contract expressly incorporated this prohibition.¹¹⁹ AEY had also been awarded other Defense Department

¹¹⁴ E-mail from Joseph Wachtel, AEY, Inc., to Yassen Kounchev, Avair, Ltd. (Mar. 18, 2008).

¹¹⁵ Letter from Kim M. Jones, Contracting Officer, U.S. Army Sustainment Command, to Efraim Diveroli, President, AEY, Inc. (Jan. 8, 2008).

¹¹⁶ Letter from Efraim Diveroli, President, AEY, Inc., to Daniel Stackwick, U.S. Army (undated).

¹¹⁷ House Committee on Oversight and Government Reform, *Transcribed Interview of Kim M. Jones* (June 19, 2008).

¹¹⁸ Defense Federal Acquisition Regulation Supplement § 252.225-7007, “Prohibition on Acquisition of United States Munitions List Items from Communist Chinese Military Companies” (Sept. 2006).

¹¹⁹ U.S. Department of Defense, *AEY, Inc. Contract W52P1J-07-D-0004*, Amendment 6 (Jan. 26, 2007).

contracts that explicitly included this prohibition.¹²⁰ For example, a contract awarded to AEY from the Defense Department on September 21, 2006, stated:

NOTICE: Prohibited Sources in the People's Republic of China. Any goods delivered under this contract may not be acquired directly or indirectly from a Communist Chinese military company.¹²¹

Documents obtained by the Committee indicate that the Defense Department terminated AEY's ammunition contract because the company procured ammunition manufactured in China and concealed this information from the Department.

As part of AEY's interactions with the Defense Department on the ammunition contract for Afghan Security Forces, AEY's president, Efraim Diveroli, executed a certification on November 25, 2007, stating that AEY was obtaining its ammunition from MFS 2000, a Hungarian company.¹²² On January 25, 2008, however, agents from the Army Criminal Investigation Division inspected ammunition delivered to Afghanistan by AEY and determined that it had been manufactured in China.¹²³

On March 25, 2008, the Defense Department suspended AEY "from future contracting with any agency in the executive branch of the United States Government."¹²⁴ The stated basis for this suspension was evidence that AEY purchased ammunition in Albania that was "manufactured in the People's Republic of China between 1962 and 1974," and AEY's certification in November 2007 that the ammunition was Hungarian.¹²⁵

On April 16, 2008, the Army issued a show cause letter for AEY's failure to deliver ammunition in accordance with the terms of the contract.¹²⁶ On May 23, 2008, the Army

¹²⁰ See, e.g., contract U.S. Department of Defense, *AEY, Inc. Contract W91GY0-06-M-1252* (Sept. 21, 2006); U.S. Department of Defense, *AEY, Inc. Contract W91GY0-06-M-0819* (June 1, 2006); U.S. Department of Defense, *AEY, Inc. Contract W910Y0-08-M-0005* (Feb. 14, 2007).

¹²¹ U.S. Department of Defense, *AEY, Inc. Contract W91GY0-06-M-1252* (Sept. 21, 2006).

¹²² AEY, Inc., Certificate of Conformance (No. AFG-0002-59) (Nov. 25, 2007).

¹²³ Letter from Kim M. Jones, Procuring Contracting Officer, U.S. Army Sustainment Command, to Efraim Diveroli, President, AEY, Inc. (May 23, 2008).

¹²⁴ Letter from Robert N. Kittel, Army Suspension and Debarment Official, to Efraim Diveroli, President, AEY, Inc. (Mar. 25, 2008).

¹²⁵ *Id.*; Memorandum from Brian A. Persico, Attorney, Procurement Fraud Branch, U.S. Army Legal Services Agency, to Army Suspension and Debarment Official (Mar. 21, 2008).

¹²⁶ Letter from Kim M. Jones, Procuring Contracting Officer, U.S. Army Sustainment Command, to Efraim Diveroli, President, AEY, Inc. (May 23, 2008).

terminated AEY's contract for default.¹²⁷ In a letter to Mr. Diveroli, the contracting officer stated that AEY had delivered ammunition "from a prohibited source and admits substantial quantities of the ammunition were, in fact, manufactured in factories in the PRC."¹²⁸

On June 19, 2008, a federal grand jury in Miami, Florida, returned a 71-count indictment against AEY, Mr. Diveroli, and three other individuals affiliated with AEY, charging them with 35 counts of procurement fraud, 35 counts of making false statements to the Army, and one count of conspiracy, arising from AEY's shipment of Chinese ammunition under this contract.¹²⁹

The Committee received information about AEY's actions from Kosta Trebicka, an Albanian businessman hired by AEY to repackage the Chinese ammunition before it was shipped to Afghanistan. Mr. Trebicka provided the Committee with ledgers from the repackaging process that identify China as the country of origin for the ammunition.¹³⁰ In a letter to the Committee, Mr. Trebicka explained that in May 2007, an AEY official instructed his employees to remove ammunition from their original Chinese packaging and place the loose rounds into cardboard boxes for shipping.¹³¹

Mr. Trebicka informed the Committee that Mr. Diveroli asked him "if there were any Chinese writings on the top of the packaging or inside the metallic cans."¹³² According to Mr. Trebicka, Mr. Diveroli instructed him to "make sure no written papers get inside the carton boxes."¹³³

This was not the only contract under which AEY took steps to conceal the Chinese origin of its military equipment. In July 2007, AEY arranged to purchase bulletproof vests for the State Department to be used by narcotics agents at the U.S. Embassy in Pakistan. E-mails from AEY's supplier reveal that the vests were made in China. The supplier informed AEY the vests were manufactured by "the vendor of choice for the Chinese Liberation Army."¹³⁴ The AEY official responded:

¹²⁷ Letter from Kim M. Jones, Procuring Contracting Officer, U.S. Army Sustainment Command, to Efraim Diveroli, President, AEY, Inc. (May 23, 2008).

¹²⁸ *Id.*

¹²⁹ Indictment, *United States v. AEY, Inc. et al.*, S.D. Fla. (No. 08-20574) (June 19, 2008).

¹³⁰ Business Ledgers from Kosta Trebicka (May 19-20, 2007).

¹³¹ Letter from Kosta Trebicka, to Majority Staff, House Committee on Oversight and Government Reform (Apr. 21, 2008).

¹³² *Id.*

¹³³ *Id.*

¹³⁴ E-mail from Harry Chang, Kendoo Technology, to Ronald Didier, AEY, Inc. (July 13, 2007).

As mentioned by Efraim earlier we would like ... to NOT mention China on any of the products.¹³⁵

The supplier responded:

Mr. Jin has notified the factory [sic] before and after the production to 100% inspect the vests to make sure there is no Chinese marking anywhere in the vest or on the box.¹³⁶

The documents suggest that AEY officials also may have concealed the Chinese origin of bulletproof vests they procured by claiming that they were made in South Korea and were merely being shipped through China. An AEY employee wrote to the company's agent:

Harry, I just spoke to Efraim and here is how we could resolve the situation (please advise) 1) the commercial invoice would show that the shipper is a South Korean company (we have the letterhead) and that you or your contact in C. is just the export company.¹³⁷

AEY appears to have used this same approach to conceal the Chinese origin of bulletproof helmets sent to Iraq. As discussed above, AEY delivered bulletproof helmets to Iraq that were substandard and accompanied by test results written in Chinese. After the contracting officer saw these Chinese documents, he contacted AEY's president, Mr. Diveroli, to clarify the origin of the helmets. Mr. Diveroli responded: "The source of these helmets is South Korea, they are then airfreighted out of Shanghai which is the main port of entry into Iraq from Asia."¹³⁸

During an interview with the Committee regarding this episode, the contracting officer stated that he was not satisfied with Mr. Diveroli's explanation. He stated:

The thing that he sent, it was not a certification from South Korea. ... I was looking for something that would attempt to certify where these helmets, the source, was from.¹³⁹

In fact, the Committee has obtained an e-mail to AEY apparently confirming that the helmets were manufactured in the same Chinese factory as the bulletproof vests. The e-mail

¹³⁵ E-mail from Ronald Didier, AEY, Inc., to Harry Chang, Kendoo Technology (July 11, 2007).

¹³⁶ E-mail from Harry Chang, Kendoo Technology, to Efraim Diveroli, President, AEY, Inc. and Ronald Didier, AEY, Inc. (Aug. 9, 2007).

¹³⁷ E-mail from Ronald Didier, AEY, Inc., to Harry Chang, Kendoo Technology (Aug. 8, 2007).

¹³⁸ E-mail from Efraim Diveroli, President, AEY, Inc., to Lt. Commander Frank Fletcher (Oct. 18, 2005).

¹³⁹ House Committee on Oversight and Government Reform, *Transcribed Interview of Commander Frank Fletcher* (June 13, 2008).

states that “the bullet proof helmet that Efrain had purchased last year was from this same factory.”¹⁴⁰

VIII. CONCLUSION

The record before the Committee indicates that the AEY contract can be viewed as a case study in what is wrong with the procurement process. The \$300 million contract appears to have been awarded despite a questionable need for the contract. The record shows that the Defense Department established deficient contract requirements and conducted a grossly inadequate assessment of AEY’s background and qualifications. After the contract was awarded, there was poor execution and oversight, resulting in the Afghan Security Forces receiving large quantities of “unservicable” ammunition.

¹⁴⁰ E-mail from Harry Chang, Kendoo Technology, to Ronald Didier, AEY, Inc. (July 13, 2007).

Chairman WAXMAN. The AEY contract shows that the procurement process at the Department of Defense is dysfunctional. There was no apparent need for the contract, no effective vetting of the company's qualifications, and no adequate oversight.

The first step in any procurement should be to ask whether the contract is necessary. That is especially true when the contract will cost taxpayers hundreds of millions of dollars. This apparently never happened. AEY acquired its ammunition from stockpiles in Albania and other former Warsaw Pact countries. These countries have surplus ammunition they are trying to give away or destroy.

We learned during the investigation that the president of Albania flew to Iraq in 2007 and offered to donate Albanian stockpiles to General Petraeus. It appears that the Army agreed to pay \$300 million for ammunition it could have gotten for free.

The procurement failure that is the hardest to understand is the selection of AEY. The State Department maintains a Watch List of potential illegal arms traffickers. Both AEY and Mr. Diveroli are on the Watch List. So are AEY's subcontractor and the subcontractor's subcontractor. The State Department official in charge of the Watch List called this a perfect trifecta. But the Defense Department never bothered to check the Watch List awarding the \$300 million arms contract.

In the source selection decision, contracting officer wrote: "There essentially is no doubt that AEY would perform in accordance with the delivery schedules and has no history of quality rated problems. Based on this, AEY's initial rating was excellent."

This was pure fiction. If Army officials had examined AEY's performance under previous Defense and State Department contracts, they would have easily discovered a dismal record of failure. Documents produced to the committee show that Federal agencies terminated, withdrew, or canceled at least seven previous contracts with AEY. Under these contracts, AEY provided potentially unsafe helmets to our forces in Iraq, failed to deliver thousands of weapons, and shipped poor quality ammunition to U.S. Special Forces.

Government contracting officials repeatedly warned of poor quality, damaged goods, junk weapons, and other equipment in the reject category, and they complained the company repeatedly engaged in bait and switch tactics that were hurting the mission.

One contracting official told us, "I just don't trust the guy. I couldn't take anything he said credibly." He told us that AEY was the single worst company he dealt with in Iraq, saying, "That was my lemon I had to make lemonade out of."

In testimony to be delivered today, the witness from the Defense Contract Management Agency continues to assert that, "AEY had a history of satisfactory performance." That is simply ridiculous. Rating AEY's performance as excellent and satisfactory is an insult to the taxpayers.

The procurement deficiencies cascaded upon each other. The terms of the contract left out essential details, allowing AEY to deliver ammunition that was over 60 years old. There were few inspections of the quality of the ammunition.

This unfortunately is not an aberration. Over the last 8 years we have witnessed a complete breakdown in the procurement process. As the AEY experience demonstrates, it appears that anyone, no

matter how inexperienced or unqualified, can win a lucrative Federal contract worth hundreds of millions of dollars.

There are profound lessons to be learned from the AEY experience. By examining AEY as a case study of what went wrong and why, we can begin to rebuild our procurement system and protect the interests of the taxpayers.

[The prepared statement of Chairman Henry A. Waxman follows:]

**Opening Statement of Rep. Henry A. Waxman
Chairman, Committee on Oversight and Government Reform
Examination of AEY Contracts with the U.S. Government
June 24, 2008**

Today's hearing examines a \$300 million contract to supply ammunition to the Afghan security forces. This contract is an important one because it relates directly to the success of our mission in Afghanistan.

We know a lot about what went wrong after the contract to AEY was awarded in January 2007. We know that ammunition provided by AEY was "unserviceable." We know that much of the ammunition was illegal Chinese-made ammunition.

We know that after paying AEY over \$60 million, the Army cancelled the contract. And we know that last week, the Justice Department indicted AEY and its top officials with 71 counts of fraud and related charges.

We have also learned that there are questions about the role of the U.S. Embassy in Albania in approving a plan to conceal the Chinese origins of AEY's ammunition. A letter I sent yesterday sought additional information about the Embassy's actions.

Today's hearing will examine what is not known: How did a company run by a 21-year-old president and a 25-year-old former masseur get a sensitive \$300 million contract to supply ammunition to Afghan forces?

My staff has prepared an analysis of the evidence that the Committee has received, and at the appropriate time, I will ask that the staff analysis and the documents it cites be made part of today's hearing record.

The AEY contract shows that the procurement process at the Department of Defense is dysfunctional. There was no apparent need for the contract, no effective vetting of the company's qualifications, and no adequate oversight.

The first step in any procurement should be to ask whether the contract is necessary. That's especially true when the contract will cost taxpayers hundreds of millions of dollars.

This apparently never happened. AEY acquired its ammunition from stockpiles in Albania and other former Warsaw Pact countries. These countries have surplus ammunition they are trying to give away or destroy. We learned during the investigation that the President of Albania flew to Iraq in 2007 and offered to donate Albanian stockpiles to General Petraeus.

It appears that the Army agreed to pay \$300 million for ammunition it could have gotten for free.

The procurement failure that is the hardest to understand is the selection of AEY.

The State Department maintains a “watch list” of potential illegal arms traffickers. Both AEY and Mr. Diveroli are on the watch list. So are AEY’s subcontractor and the subcontractor’s subcontractor. The State Department official in charge of the watch list called this “a perfect trifecta.”

But the Defense Department never bothered to check the watch list before awarding the \$300 million arms contract.

In the source selection decision, the contracting officer wrote: “There essentially is no doubt that AEY would perform in accordance with the delivery schedules and has no history of quality rated problems. Based on this, AEY’s initial rating was ‘Excellent.’”

This was pure fiction.

If Army officials had examined AEY’s performance under previous Defense and State Department contracts, they would have easily discovered a dismal record of failure.

Documents produced to the Committee show that federal agencies terminated, withdrew, or cancelled at least seven previous contracts with AEY. Under these contracts, AEY provided potentially unsafe helmets to our forces in Iraq, failed to deliver thousands of weapons, and shipped poor quality ammunition to U.S. Special Forces. Government contracting officials repeatedly warned of “poor quality,” “damaged goods,” “junk” weapons, and other equipment in “the reject category.” And they complained the company repeatedly engaged in “bait and switch” tactics that were “hurting the mission.”

One contracting official told us: “I just don’t trust the guy. ... I couldn’t take anything he said credibly.” He told us that AEY was the single worst company he dealt with in Iraq, saying: “that was my lemon I had to make lemonade out of.”

In testimony to be delivered today, the witness from the Defense Contract Management Agency continues to assert that “AEY had a history of satisfactory performance.” That’s simply ridiculous. Rating AEY’s performance as “excellent” and “satisfactory” is an insult to the taxpayer.

The procurement deficiencies cascaded upon each other. The terms of the contract left out essential details, allowing AEY to deliver ammunition that was over 60 years old. There were few inspections of the quality of the ammunition.

This, unfortunately, is not an aberration. Over the last eight years, we have witnessed a complete breakdown in the procurement process. As the AEY experience demonstrates, it appears that anyone — no matter how inexperienced or unqualified — can win a lucrative federal contract worth hundreds of millions of dollars.

There are profound lessons to be learned from the AEY experience. By examining AEY as a case study of what went wrong and why, we can begin the process of rebuilding our procurement system and protecting the interests of the taxpayer.

Chairman WAXMAN. I want to recognize Mr. Davis for his opening statement.

Mr. DAVIS OF VIRGINIA. Thank you, Chairman Waxman, for holding the hearing.

Last Friday's indictment of AEY's officials certainly justifies this committee's decision to pursue questions about how and why a small, inexperienced company was awarded a Federal contract worth hundreds of millions of dollars. Obvious evidence of consistently shoddy performance was somehow missed or ignored as substandard or illegally obtained munitions were apparently being sent to Afghanistan.

The system eventually caught up with AEY, but it took too long and it cost too much. The failure to root out AEY sooner highlights the difficulties that can arise in trying to capture and use information on a contractor's past performance. That such a bad apple continued to receive Federal contracts only strengthens my belief that a well-maintained data base of current information on prior violations and other relevant information could be a valuable tool for contracting officers.

Such a data base was proposed in H.R. 33, and we appreciate Chairman Waxman and the bill's sponsor, Representative Maloney, for working with us to improve the latest version of the bill. It still needs some work, but with derogatory information on performance issues available only to acquisition officials, the data base could provide the tool the Government needs to root out the rotten apples before they can spoil even the most valuable barrels.

Perhaps if we had acted faster to put such a system in place we wouldn't be having a hearing today, but other gaps in the contracting system also appear to have played a key role in this fiasco.

It is one thing to have the appropriate information on past performance available; it is quite another to be able to use it effectively. In interviews with various contracting officials involved in the AEY transactions, the impact of the Small Business Administration's Certificate of Competency process surfaced several times. Under that statutory scheme, contracting officials are prohibited from rejecting an offer from small businesses such as AEY only on the basis the company is not a responsible perspective contractor due to negative or marginal past performance. Instead, the matter must be referred to the SBA, which decides whether the firm is eligible for award.

While I understand that this program was designed for the protection of legitimate small business firms, it might be useful, in light of this case, to take a careful look at the impact of the process. We should ask whether it has an intimidating impact on contracting officials who might otherwise reject a firm as non-responsible for reasons such as bad past performance, but are reluctant to do so because of the delay and extra paperwork required by the SBA referral process.

This case seems to speak volumes about what is wrong with the military contracting process today. Yet again we see poor decision-making by overworked and under-trained Army acquisition officials. Over the course of awarding and monitoring 29 contracts worth more than \$200 million, someone, somewhere should have

heard an alarm bell and looked more closely at what this small company was doing with an implausibly large set of tasks.

But we should take care before extrapolating this specific, hopefully unique facts of AEY, and any broad conclusions about the entire acquisition system. This is a sordid tale of greed and ineptitude involving repackaged Chinese munitions, alleged kickbacks to an Albanian government official, and phantom plane crashes. There is little indication the United States routinely purchases ammunition for vintage Soviet weapons from 22-year-old arms dealers, so we should ask what needs fixing while keeping an eye on what needs to keep working in the vast majority of contract transactions to taxpayers can have their money spent efficiently and wisely. Meaningful reforms are based on data, not anecdotes, even sensational ones.

Today's testimony should add important information to the public record about the mistakes and waste at the heart of the AEY debacle, and we welcome the witnesses.

Thank you.

[The prepared statement of Hon. Tom Davis follows:]

HENRY A. WAXMAN, CALIFORNIA
CHAIRMAN

TOM DAVIS, VIRGINIA
RANKING MINORITY MEMBER

ONE HUNDRED TENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

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Minority (202) 225-5074

Statement of Rep. Tom Davis

Ranking Republican Member

Committee on Oversight and Government Reform

"Examination of AEY Contracts with the U.S. Government"

June 24, 2008

Thank you, Chairman Waxman, for holding this hearing.

Last Friday's indictment of AEY officials certainly justifies the Committee's decision to pursue questions about how and why a small, inexperienced company was awarded federal contracts worth hundreds of millions of dollars. Obvious evidence of consistently shoddy performance was somehow missed or ignored as substandard or illegally-obtained munitions were apparently being sent to Afghanistan. The system eventually caught up with AEY, but it took too long and cost too much.

The failure to root out AEY sooner highlights the difficulties that can arise in trying to capture and use information on contractors' past performance. That such a bad actor could continue to receive federal contracts only strengthens my belief that a well maintained database of current information on prior violations and other relevant information could be a valuable tool for contracting officers. Such a database was proposed in H.R. 3033, and we appreciate Chairman Waxman and the bill's sponsor, Representative Carolyn Maloney, working with us to improve the latest version of the bill. It still needs some work, but with derogatory information on performance issues available only to acquisition officials, the database could provide the tool the government needs to root out the rotten apples before they can spoil even more valuable barrels. Perhaps if we had acted faster to put such a system in place, we wouldn't be having this hearing today.

But other gaps in the contracting system also appear to have played a role in the AEY fiasco. It's one thing to have the appropriate information on past performance available; quite another to be able to use it effectively. In interviews with various contracting officials involved in the AEY transactions, the impact of the Small Business Administration's Certificate of Competency (COC) process surfaced several times. Under that statutory scheme, contracting officials are prohibited from rejecting an offer from small businesses, such as AEY, only on the basis the company is not a "responsible" prospective contractor due to negative or marginal past performance. Instead, the matter must be referred to the Small Business Administration (SBA) which decides whether the firm is eligible for award.

*Statement of Rep. Tom Davis
June 24, 2008
Page 2 of 2*

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This case seems to speak volumes about what’s wrong with the military contracting process today. Yet again we see poor decision making by overworked and undertrained Army acquisition officials. Over the course of awarding and monitoring 29 contracts worth more than \$200 million, someone somewhere should have heard an alarm bell and looked more closely at what this small company was doing with an implausibly large set of tasks.

But we should take care before extrapolating the specific – hopefully unique – facts of AEY into any broad conclusions about the entire acquisition system. This is a sordid tale of greed and ineptitude involving repackaged Chinese ammunitions, alleged kickbacks to an Albanian government official, and phantom plane crashes. There is little indication the United States routinely purchases ammunition for vintage Soviet weapons from 22-year old arms dealers. So we should ask what needs fixing while keeping an eye on what needs to keep working in the vast majority of contract transactions so taxpayer dollars are spent efficiently and wisely. Meaningful reforms are based on data, not anecdotes, even sensational ones.

Today’s testimony should add important information to the public record about the mistakes and waste at the heart of the AEY debacle and we welcome the witnesses.

Chairman WAXMAN. Thank you very much, Mr. Davis.

We are pleased to have before us today from the Defense Department Brigadier General William N. Phillips, the Commander General of Picatinny Arsenal, Commander of the Joint Munitions and Lethality Life Cycle Management Command, and the Program Executive Officer for Ammunition. He is accompanied by Jeffery P. Parsons, Executive Director of the Army Contracting Command at the U.S. Army Materiel Command.

Mitchell A. Howell, Executive Director of the Ground Systems and Munitions Division at the Defense Contract Management Agency.

From the State Department we have Stephen D. Mull, Acting Assistant Secretary of State for the Bureau of Political Military Affairs.

We also invited officials from AEY, Efraim Diveroli, the president of AEY, and David Packouz, the vice president. Mr. Diveroli and Mr. Packouz are not with us today. Both individuals informed us, through letters from their attorneys, that they would assert their fifth amendment rights against self-incrimination and would refuse to answer questions at the hearing.

I ask unanimous consent that both letters be made part of the hearing record. Without objection, that will be the order.

[The information referred to follows:]



LAW OFFICES OF MARC DAVID SEITLES, P.A.
Trial & Appellate Practice

June 18, 2008

Chairman Henry Waxman
House of Representative
Committee on Oversight and Government Reform
2157 Rayburn House Office Building
Washington, DC 20515-6143

Dear Mr. Waxman:

I am one of the attorneys that represent Mr. David M. Packouz in an ongoing criminal investigation related to AEY, Inc. and Efraim Diveroli. I have been advised by attorneys from your Committee that you are requesting his testimony before the House Oversight Committee on June 24, 2008. Respectfully, Mr. Packouz must again decline this invitation.

Mr. Packouz has cooperated for the past eight months with the government, law enforcement agents, and prosecutors in its investigation of AEY. At least two agents from ICE and DCIS met with Mr. Packouz on multiple occasions where Mr. Packouz was debriefed for several hours. The agents were impressed with Mr. Packouz's candor, completeness, and humility. As a result, undersigned was informed by both agents that they would try to ensure that Mr. Packouz did not get prosecuted. Nevertheless, the United States Attorney's Office in the Southern District of Florida has decided to indict Mr. Packouz.

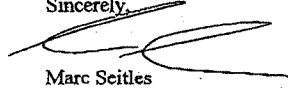
As a result, Mr. Packouz may not respond to any questions before your Committee at this time. Indeed, AUSA Eloisa Fernandez informed me that she could use any statement provided by Mr. Packouz to the Committee against him. Because Mr. Packouz strongly believed he would not be charged in this matter, he must now weigh his options regarding how he will defend himself from these allegations. Thus, Mr. Packouz will be obligated to invoke his Fifth Amendment right to each and every substantive question regarding AEY.

Mr. Packouz should seriously be considered as a candidate for transactional immunity. He did not profit one dollar from this scheme, and left the company before AEY profited from its contract with the government. Further, Mr. Packouz provided invaluable information to agents that helped streamline this investigation. Retired Special Agent Oscar Garcia, ICE and DCIS Agent Michael Mentavlos can both attest to Mr. Packouz's complete honesty and forthrightness regarding all material matters related to AEY.

I firmly believe that if transactional immunity is offered to Mr. Packouz, he could provide the Committee with relevant and useful information that could lead to legislative changes in how United States' military contracts are awarded.

I look forward to your response. If you have any questions, please do not hesitate to contact me at 305-379-6667.

Sincerely,

A handwritten signature in black ink, appearing to be 'Marc Seitles', with a stylized, sweeping flourish extending to the right.

Marc Seitles

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June 18, 2008

Theodore Chuang, Esq.
Staff Attorney
House of Representatives
Committee on Oversight and Government Reform
2157 Rayburn House Office Building
Washington, D.C. 20515-6143

Re: *Efraim Diveroli*

Dear Mr. Chuang:

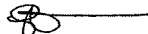
This letter is in response to your telephone conversation with Hy Shapiro and me last week, and your telephone conversation with Mr. Shapiro again today, regarding Mr. Efraim Diveroli and your request that he appear and provide testimony before the House of Representatives, Committee on Oversight and Government Reform (hereinafter referred to as the "Committee").

As we discussed, Mr. Diveroli, through his counsel, has been advised by the U.S. Attorney's Office in Miami, Florida that he and AEY, Inc. are the targets of a federal criminal grand jury investigation. As such, if subpoenaed to testify before the Committee, Mr. Diveroli would assert his Fifth Amendment right under the Constitution and refuse to answer any questions put to him by members of the Committee. Mr. Diveroli would consider testifying, however, under certain terms and conditions, which would include a grant of transactional immunity so that he could be assured that his testimony would and could not be used against him in any criminal proceeding.

As we have indicated previously, there are significant issues with the manner in which the Arms Export Control Act and the International Traffic in Arms Regulations are being applied in this case, in particular the application of the brokering regulations. In addition, the U.S. Army has taken inconsistent positions regarding the acceptance of munitions list items which originated in China prior to the implementation of the 1989 arms embargo. Both Mr. Shapiro and I are willing to meet and discuss these issues with you within the context of Rule 11 of the Federal Rules of Criminal Procedure.

If you have any questions, please feel free to telephone me at (213) 892-1865 or Mr. Shapiro at (305) 854-8989.

Sincerely,



Mary Carter Andruets

cc: Hy Shapiro, Esq.

Chairman WAXMAN. In fact, both men were indicted last week on Federal charges of procurement fraud, false statements, and conspiracy, so their Fifth Amendment concerns would appear to be well-founded.

I should also note that, as part of their bail conditions, the Federal Court has restricted their travel to the Miami area.

Under these circumstances we concluded that it did not make sense to require them to appear today.

We are pleased to have our witnesses from the Defense Department and the State Department with us today.

It is the practice of our committee that all witnesses that testify before us and those who are accompanying them answer questions under oath, so I would like to ask you all to please stand and raise your right hands.

[Witnesses sworn.]

Chairman WAXMAN. The record will indicate that each of the witnesses answered in the affirmative.

Why don't we start with Brigadier General Phillips.

General PHILLIPS. Mr. Chairman, if I could, I would like to let Mr. Parsons go first, sir. He is the lead for the Army here. He is the Director of the Army Contracting Command, and I am here with him, so, so I would like to defer to Mr. Parsons if that is OK.

Chairman WAXMAN. OK. Thank you.

Mr. Parsons.

STATEMENTS OF JEFFERY P. PARSONS, EXECUTIVE DIRECTOR, ARMY CONTRACTING COMMAND, U.S. ARMY MATERIEL COMMAND; BRIGADIER GENERAL WILLIAM N. PHILLIPS, U.S. ARMY, COMMANDING GENERAL, PICATINNY ARSENAL, COMMANDER, JOINT MUNITIONS AND LETHALITY LIFE CYCLE MANAGEMENT COMMAND; MITCHELL A. HOWELL, EXECUTIVE DIRECTOR, GROUND SYSTEMS AND MUNITIONS DIVISION, DEFENSE CONTRACT MANAGEMENT AGENCY; AND STEPHEN D. MULL, ACTING ASSISTANT SECRETARY OF STATE, BUREAU OF POLITICAL MILITARY AFFAIRS, U.S. DEPARTMENT OF STATE

STATEMENT OF JEFFERY P. PARSONS

Mr. PARSONS. Chairman Waxman, Congressman Davis, and distinguished members of the Committee on Oversight and Government Reform, I appreciate the opportunity to appear before you and discuss your concerns regarding the award of a contract to AEY, Inc., to supply ammunition to the Afghanistan Army and Afghanistan National Police.

The U.S. Army is conducting an extensive review with this contract action to determine if policies, procedures, rules, and regulations were properly followed in the pre-award, award, and post-award phases of the contract.

While I did not identify any breaches in policies, procedures, rules, and regulations, we certainly learned a great deal in our review and identified a number of improvements to make to our acquisition process.

Here with me today, as you know, is General Phillips, the Commanding General of the Army Materiel Command's Joint Muni-

tions and Lethality Life Cycle Management Command. General Phillips will address some of the improvements we are making in the management and acquisition of non-standard ammunition, to include specifications, packaging, inspection, and acceptance.

I respectfully request that our joint written statement be made a part of the record for today's hearing.

Chairman WAXMAN. Without objection, that will be the order.

Mr. PARSONS. As Executive Director of the Army Contracting Command, I carefully reviewed the contracting process associated with the AEY contract. I reviewed and discussed the source selection process with the contracting officer. I also reviewed relevant documents such as the pre-award survey, minutes from the contract post-award survey, meeting between the ACO and AEY, and post-award documentation to include reports of discrepancy provided by the Combined Security Transition Command Afghanistan.

Just recently I visited Afghanistan and had the opportunity to meet with the Combined Security Transition Command Afghanistan leadership and members of the Afghanistan Army. My review indicated that the contracting officer properly followed the contracting process and made reasonable judgments based upon the factual information in her possession. As we have come to learn, however, there was some factual past performance information that was not in the possession of the contracting officer at the time of the contract award.

Based upon our review, we identified a number of small contract actions awarded by offices in the Army Contracting Agency where AEY had been terminated for cause in 2006 prior to the award of the contract in January 2007. This information was not visible to the contracting officer, as the dollar thresholds of the terminated contracts did not require the recording of past performance information in accordance with the Defense Federal Acquisition Regulations Supplement.

As a result, there were no reports of past performance in the past performance information management system that is used in the source selection process to evaluate an offeror's past performance.

Although those terminated actions were not included in the past performance information management system, the solicitation did include FAR-52-209-5 certification regarding responsibility matters, which required AEY to identify whether they had one or more contracts terminated for default in the preceding 3 years by any Federal agency. The provision also requires an offeror to provide immediate written notice to the contracting officer if at any time prior to contract award the offeror learns that his certification was erroneous when submitted or has become erroneous by reason of changed circumstances. Again, AEY did not indicate to the contracting officer that they had several contracts that had been terminated for cause prior to the award of the ammunition contracts.

We have informed our procurement fraud attorneys of this situation to determine if AEY provided false certifications during the solicitation phase of the contract. In addition, we have initiated policy changes within the Army that will require the posting of past performance information, regardless of dollar value, for all contracts that have been terminated for cause or default.

I believe similar policy changes are being considered at the DOD level, and I would recommend similar policy changes at the Federal level.

In my opinion, while there certainly is room for improvement in the way we acquire non-standard ammunition in support of our allies, this case is more about a contractor who failed to properly represent their company and failed to comply with the terms and conditions of the contract, rather than a faulty contracting process.

Once the contracting officials at the Army Sustainment Command became aware of performance issues in February 2008, they initiated actions to ensure compliance with the contract.

Once matters became known to the Procurement Fraud Division regarding the Chinese ammunition, they suspended them from further Government contracts. Based upon a show-cause letter that the contracting officer issued to AEY and their admission that there was Chinese ammunition provided under this contract, they were terminated for default on May 23, 2008.

Last week's indictment of AEY president and several other company officials is yet further indication of a less than scrupulous contractor.

The Army is in the process of re-procuring ammunition requirements in support of the Afghanistan Army and National Police. We have issued several contracts to meet short-term, critical needs and will apply lessons learned to our new procurement. We will also pursue re-procurement costs from AEY consistent with the Federal Acquisition Regulations.

I appreciate the congressional support of our Army's efforts in providing our Nation's war fighters and allies with quality products and services. We continue to pursue improvements in our contracting process and work force, as demonstrated by our Secretary's commitment to implement many of the recommendations in the Gansler Commission report regarding Army acquisition and program management and expeditionary operations.

I look forward to your questions.

Chairman WAXMAN. Thank you, Mr. Parsons.

General Phillips.

STATEMENT OF BRIGADIER GENERAL WILLIAM N. PHILLIPS

General PHILLIPS. Chairman Waxman, Congressman Davis, distinguished members of this committee, it is a privilege to appear before you and to have an opportunity to address the support that we are providing to a key ally.

As head of the Joint Munitions and Lethality Life Cycle Management Command, I have sought to gather lessons learned from our experience with AEY and non-standard ammunition and apply them simply to improve our process.

In early April, as a direct result of the AEY contract review that Mr. Parsons just mentioned, we established a team of subject matter experts in contracting, program management, and contract administration, which included the Defense Contract Management Agency, who continues to play a key role, as well as the Combined Security Transition Command in Afghanistan. Members of my command have spent the past 2 weeks in Afghanistan and Iraq work-

ing with our forces on the ground. We have recognized the need to improve how we acquire non-standard foreign ammunition.

Let me again emphasize that we have worked with all our key partners, to include DCMA, to study non-standard ammunition procurement procedures from acquisitions to contracts to delivery. As a result, future standards for quality, packaging, transportation, and technical specification elements for non-standard ammunition will more clearly state what we expect from our contractors.

These new terms and conditions have been prepared and have been staffed with industry and other OSD offices for their comments. A request for a proposal has been prepared with these new standards and will be published in early July for industry to respond.

Let me add that our response from industry has been very important, and we have sought to capture lessons learned from them and apply that to our request for proposal process.

As part of our process and to enforce quality standards of non-standard ammunition before shipment, DCMA and the Joint Munitions and Lethality Life Cycle Command will send trained personnel to the point of origin for non-standard ammunition contracts to verify ammunition type, quantity, and condition.

The Army has moved aggressively to address this matter from the first notification of the problems in the field, and our actions have been prompt and fair. We also continue to pursue improvements to our contracting process as a result of this experience. Your Army is committed to ensuring our soldiers and allies are properly prepared to continue the fight against the global war on terrorism.

In closing, let me just add that we thank Congressman Waxman and Congressman Davis, thank you and this distinguished committee for your support for our soldiers, our service members, and our allies.

I look forward to your questions.

[The prepared joint statement of General Phillips and Mr. Parsons follows:]

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STATEMENT BY

BRIGADIER GENERAL WILLIAM N. PHILLIPS
COMMANDING GENERAL, PICATINNY ARSENAL
COMMANDER, JOINT MUNITIONS & LETHALITY LIFE CYCLE MANAGEMENT
COMMAND
PROGRAM EXECUTIVE OFFICER AMMUNITION

AND

MR. JEFFERY P. PARSONS
EXECUTIVE DIRECTOR
ARMY CONTRACTING COMMAND (PROVISIONAL)
U.S. ARMY MATERIEL COMMAND

BEFORE THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES

ON

WEAPONS, AMMUNITION, AND MUNITIONS SALES TO IRAQ AND AFGHANISTAN

SECOND SESSION, 110TH CONGRESS

JUNE 24, 2008

NOT FOR PUBLICATION
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COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES

Thank you for this opportunity to report to you on the United States Army Materiel Command's support to the Afghan National Army and Afghan National Police, and specifically the Army's contract with AEY, Inc. to supply ammunition to the Afghan forces.

The Department of Defense (DOD) places the safety of U.S. and allied Soldiers as a priority in the global war on terrorism. As a result of our concern with regard to contractor performance, we are conducting a thorough review to ensure our Afghan allies are provided with good quality ammunition, and to ensure the soundness of the processes the Army uses to acquire supplies for its allies.

The majority of the Afghan Security Forces use former Warsaw Pact weapons systems which require former Warsaw Pact or foreign ammunition. The United States Army considers this ammunition as non-standard ammunition because it is produced by foreign sources, and it may not meet the same specifications that we use in acquiring U.S. ammunition. Since the U.S. currently neither maintains nor produces this type of ammunition, we contracted to supply this non-standard ammunition from the commercial marketplace. Let me stress that 'non-standard' does not mean 'substandard'.

In April 2006, a requirement for the procurement of ammunition for use in weapons by Afghan National Security Forces was processed by the United States Army Security Assistance Command (USASAC) through the Foreign Military Sales (FMS) program. USASAC forwarded this requirement to its Security Assistance Element located in the Joint Munitions Command (JMC). The Joint Munitions Command is now a part of the Army Joint Munitions and Lethality Life Cycle Management Command - - the Army's principal command responsible for ammunition procurement. In July 2006, the Army Sustainment Command Acquisition Center - - the contracting office for the Joint Munitions Command - - proceeded in accordance with the Federal Acquisition Regulation (FAR) to solicit offers for a two-year requirements contract. This competition was conducted on a full-and-open competition basis. Ultimately, eight offers were evaluated.

The evaluation focused on the past performance of the offerors' recent contracts, the quality and timeliness of their past performance, their experience in systems integration (i.e., identification of ammunition appropriate for foreign weapons), international movement and the degree to which they intended to utilize small businesses in the performance of the contract. While AEY, Inc. properly certified itself as a Small Business, the full-and-open nature of the competition gave large and small businesses the same opportunity to propose against the requirement. The results of the evaluation indicated AEY, Inc's proposal offered the best value to the Government in terms of past performance, price and small business utilization.

Prior to awarding the contract, the contracting officer asked the Defense Contract Management Agency (DCMA) to review AEY, Inc.'s financial capability, its accounting system and transportation capabilities. After its review of AEY, Inc., DCMA recommended a complete award based on satisfactory findings. The survey included a check of the Excluded Parties List System, which did not show AEY, Inc., or any related affiliates or any company official as being debarred. At the same time and in support of DCMA, the Defense Contract Audit Agency (DCAA) reviewed the company's accounting system. DCAA, in a meeting at AEY, Inc.'s office in Miami, found the company to be in compliance with the necessary accounting standards for government contracts.

Based upon all information available including a legal review, the contracting officer awarded a two-year, firm fixed price requirements contract to AEY, Inc on January 26, 2007. Throughout the acquisition process, the Army followed all applicable procurement policies and procedures in making this best value award decision. The contract required that the ammunition be serviceable and issued without qualification. The contract specified that this ammunition may be produced under NATO specification, Warsaw Pact specification, and/or commercial equivalent. The contract also required the contractor to submit a Certificate of Conformance (COC) with each delivered shipment attesting to the contractor's compliance with contract requirements.

Additionally, the contract incorporated Defense Federal Acquisition Regulation 252.225-7007, dated September 2006, prohibiting the acquisition of Munitions List Items from Communist Chinese military companies, either directly or indirectly.

The contract also called for the ammunition to be packaged in accordance with the best commercial practice for international shipment. We previously used this specification -- "best commercial practice for international shipment" -- in other FMS sales for non-standard ammunition and believed it adequate for this contract as well due to the success on previous contracts.

In January 2008, JMC received unofficial reports from the Combined Security Transition Command - Afghanistan (CSTC-A) regarding the condition of packaging of some of the ammunition delivered by AEY, Inc. When CSTC-A sent its formal Reports of Discrepancy (ROD) in February 2008, JMC and the contracting officer immediately notified AEY, Inc. that its packaging did not meet the contract requirements. The Army met with AEY, Inc. on February 28, 2008 in Rock Island, Illinois and outlined our required corrective actions.

On March 17, 2008, JMC and the contracting officer received the first RODs, dated March 1, 2008, regarding quality and previously identified packaging issues associated with the recent deliveries of 1 million rounds of ammunition to CSTC-A. AEY, Inc. had previously shipped over 125 million rounds of ammunition successfully.

The Government issued a corrective action letter to AEY, Inc. on March 18, 2008. The letter highlighted the ammunition discrepancies and required AEY, Inc. to submit a corrective action plan. AEY, Inc. submitted its plan to the contracting officer on March 28, 2008.

The allegation against AEY, Inc. that led to its suspension by the Army is that the company procured ammunition that was originally produced in China, in direct violation of contract requirements. AEY, Inc. certified that the ammunition was manufactured in Hungary. As a result of these allegations, the Army suspended AEY, Inc. on March 26, 2008. The Army is aware of a Department of Defense Inspector General (DODIG) complaint against AEY, Inc. and continues to assist the DODIG and other law enforcement agencies.

After assessing the information used by the Army to suspend AEY, Inc. and providing AEY, Inc. the opportunity to show cause why its contract should not be terminated, on May 23, 2008, the contracting officer terminated AEY, Inc.'s contract to supply ammunition to CSTC-A. This termination for default is based on AEY, Inc.'s failure to deliver conforming ammunition in accordance with the contract terms.

As an Army, we continually assess how we are meeting the needs of our customers and ensuring that we are improving our business practices. Our procurement of this non-standard ammunition met a need to support military operations

by Afghan National Security Forces. However, as a result of our review into this matter, we recognize that changes need to be made in our acquisition of non-standard ammunition. We have already made changes to our packaging, transportation and technical standards for non-standard ammunition and will ensure we cite specific requirements we expect our contractors to meet. We now stipulate specific compliance with the International Civil Aviation Organization (ICAO) Technical Instructions for the Safe Transport of Dangerous Goods for air movement and International Maritime Dangerous Goods (IDMG) Code for surface movements. This ensures that we also specifically cite Title 49 of the Code of Federal Regulations as the applicable US standard and hold our contractors to that standard. We have also chartered a team of subject matter experts to better define the quality standards necessary for future non-standard ammunition requirements, how and where the ammunition should be inspected, and the best DOD agency to accomplish these inspections. We have also continued to focus on supporting the urgent ammunition needs of CSTC-A and have provided their most urgent critical ammunition requirements which incorporated these improved standards for packaging, transportation and quality.

As a longer-term resolution of contracting issues, the Army is implementing the recommendations of the Commission on Army Acquisition and Program Management in Expeditionary Operations, which released its final report, "Urgent Reform Required: Army Expeditionary Contracting," on October 31, 2007.

The Gansler Commission provided an independent, long-term, strategic assessment of the Army's acquisition and contracting system – and its ability to support expeditionary operations and sustained high operational demand in an era of persistent conflict. To complement the work of the Commission, the Army Contracting Task Force was established to review current contracting operations and take immediate action where appropriate. The recommendations of the Commission were consistent with the findings of the Task Force.

We are currently addressing structural weaknesses and shortcomings identified, with a view to improving both current and future expeditionary contracting operations. We are committed to finishing the development and then implementing an Army-wide contracting campaign plan to improve doctrine, organization, training, leadership, materiel, personnel, and facilities. Achieving this objective will require resources, time, and sustained leadership focus. The contracting campaign plan will continue the initiatives already underway in the Army.

Secretary Geren directed the realignment of the U.S. Army Contracting Agency (ACA) to the U.S. Army Materiel Command (AMC) and the establishment of the U.S. Army Contracting Command (ACC) (Provisional) under AMC. The ACC (Provisional) stand-up ceremony on March 13, 2008 is in keeping with the Gansler Commission's recommendation to restructure Army contracting organizations and restore responsibility to better facilitate contracting and contract management in expeditionary

and U.S.-based operations. The ACC, whose first Executive Director, Mr. Jeff Parsons, is with me today, is a two-star level command with (2) one-star level subordinate commands – an Expeditionary Contracting Command and an Installation Contracting Command.

The Gansler Commission recognized that the Army needs an additional 1,400 contracting officers to perform our mission. We, in the Army, are addressing that need and ask the Committee to recognize that experienced contracting officers take years to develop. The additional personnel and the reorganization of Army contracting are the solutions to contracting issues we face now and in the future.

We firmly believe we are on the right track and that we will improve our overall contracting processes while continuing to supply the Afghan National Security Forces and other allies with the material that they need.

Chairman WAXMAN. Thank you very much.
Mr. Howell.

STATEMENT OF MITCHELL HOWELL

Mr. HOWELL. Chairman Waxman, Congressman Davis, and distinguished members of the Committee on Oversight and Government Reform, I appreciate the opportunity to appear before you and discuss your concerns about the Defense Contract Management Agency's contract administration and, more particularly, product acceptance processes for various types of nonstandard ammunition.

The contract at issue was for the procurement and delivery of various nonstandard ammunition types for the Afghanistan National Police and the Afghanistan National Army. The contract was awarded in January 2007 to AEY, Inc., located in south Florida.

The Joint Munitions and Lethality Life Cycle Management Command, through their supporting acquisitions center at Rock Island, IL, requested a pre-award survey from the DCMA in December 2006. Their request to DCMA was for an analysis of AEY's financial and transportation capability. In January 2007 DCMA found AEY to be satisfactory in both of the evaluated capabilities.

AEY had a history of satisfactory performance on similar contracts, showing increasing revenue growth, adequate capitalization, and was considered low-risk for the evaluated capabilities.

DCMA conducted a post-award conference in March 2007 with AEY representatives to confirm contract technical, quality, and safety performance requirements. At the meeting it was understood that all ammunition would be off the shelf and previously manufactured. All storage, packaging, and transportation were required to be international best commercial practices. AEY confirmed their understanding of these requirements. The contract's packaging and quality terms and conditions specified by the Buying Command had been utilized in previous contracts without any identified discrepancies.

The contract required kind, count, and condition inspection. There was no age limitation on the procured ammunition. Product acceptance took two distinct forms. For domestic sources, acceptance was performed at origin. For outside the continental United States, OCONUS, sources, acceptance was performed at destination.

The contract terms allowed the contractor to submit certificates of conformance for OCONUS sourced items. The Federal Acquisition Regulation authorized buying commands to allow contractor use of COCs in lieu of more stringent Government inspection criteria, especially where risk is determined to be low.

In addition, the Government maintains its inspection rights, regardless of whether the contract allows for use of COCs or not.

The items of concern originated from OCONUS sources. The OCONUS shipments were delivered to the airport in Afghanistan. Due to limitations at the airfield, kind, count, and condition, inspection took place after movement of the ammunition from the air field to the bunkers. Ordinance commissioned and non-commissioned officers conducted that inspection. These officers have specialized ammunition training and the expertise necessary to perform kind, count, and condition inspection.

COCs were acknowledged by the ordinance officers at the delivery point. In these COCs, the contractor certified the ammunition provided was in acceptable condition and could be safely fired in an originally chambered weapon or weapon system.

Due to the off-the-shelf nature of the OCONUS source non-standard ammunition, DCMA's inspection and acceptance services were very limited. For OCONUS-to-OCONUS shipments, these duties primarily involve processing payment after receipt of invoices and a COC signed by both the contractor and the ordinance officer conducting the inspection.

DCMA has been a critical strategic partner in helping the Buying Command fashion a new acquisition strategy for non-standard ammunition. Letters of delegation requiring enhanced scrutiny of non-standard ammunition items have recently been accepted by DCMA. We have already performed some of these delegated functions on short notice in support of urgent ammunition requests.

We are confident that the more stringent specifications and corresponding inspection and acceptance requirements will greatly enhance the likelihood that only conforming ammunition will be presented and accepted in the future.

DCMA is fully engaged with our Buying Command partners to ensure we continue to improve the processes related to the acquisition and acceptance of non-standard ammunition.

In addition to the improvements already mentioned, DCMA's internal realignment enhances our Contract Administration operations. Subsequent to the award of this contract, DCMA realigned into product groupings, including the Munitions and Support System's Contract Management Office facilitating better customer service and subject matter expertise minimizing the potential for situations like this one in an environment of increasing mission and constrained resources.

We appreciate the congressional support of our efforts as the Department's primary contract management agency in providing our Nation's war fighters and allies with quality products and services.

Again, thank you for the opportunity to appear before this committee today to address DCMA's role in this matter.

I will now answer any questions the committee may have.

[The prepared statement of Mr. Howell follows:]

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STATEMENT BY

**MITCHELL A. HOWELL
EXECUTIVE DIRECTOR, GROUND SYSTEMS AND MUNITIONS
DIVISION
DEFENSE CONTRACT MANAGEMENT AGENCY**

BEFORE THE

**COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES**

ON

**WEAPONS, AMMUNITION, AND MUNITIONS SALES TO IRAQ AND
AFGHANISTAN**

SECOND SESSION, 110TH CONGRESS

JUNE 24, 2008

**NOT FOR PUBLICATION
UNTIL RELEASED BY THE
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES**

Chairman Waxman, Congressman Davis and distinguished members of the Committee on Oversight and Government Reform, I appreciate the opportunity to appear before you and discuss your concerns about the Defense Contract Management Agency's (DCMA) contract administration and more particularly product acceptance processes for various types of non-standard ammunition. The contract at issue was for the procurement and delivery of various non-standard ammunition types for the Afghanistan National Police and the Afghanistan National Army. The contract was awarded in January 2007 to AEY, Inc., located in South Florida. The Joint Munitions and Lethality Life Cycle Management Command (JM&L LCMC), through their supporting Acquisition Center at Rock Island, Illinois, requested a limited pre-award survey from DCMA in December 2006. Their request to DCMA was limited to an analysis of AEY's financial and transportation capability. In January 2007, DCMA found AEY to be satisfactory in both of the evaluated capabilities. AEY had a history of satisfactory performance on similar contracts, showed increasing revenue growth, adequate capitalization and was considered low risk for the evaluated capabilities. DCMA conducted a post-award conference in March 2007 with AEY representatives to confirm contract technical, quality and safety performance requirements. At the meeting, it was understood that all ammunition would be off-the-shelf and previously manufactured. All storage, packaging, and transportation were required to be to international best commercial practices. AEY affirmed their

understanding of these requirements. The contract's packaging and quality terms and conditions, specified by the buying command, had been utilized in previous contracts without any identified discrepancies.

The contract required kind, count and condition inspection. There was no age limitation on the procured ammunition. Product acceptance took two distinct forms. For domestic sources, acceptance was performed at origin. For outside the continental United States (OCONUS) sources, acceptance was performed at destination. The contract terms allowed the contractor to submit "Certificates of Conformance" (COC) for OCONUS-sourced items. The Federal Acquisition Regulation (FAR) authorizes buying commands to allow contractor use of COCs in lieu of more stringent government inspection criteria, especially where risk is determined to be low. In addition, the government maintains its inspection rights regardless of whether the contract allows for the use of COCs or not.

The items of concern originated from OCONUS sources. The OCONUS shipments were delivered to the airport. Due to limitations at the airfield, kind, count, and condition inspection took place after movement of the ammunition from the airfield to the bunkers. Ordnance commissioned and non-commissioned officers conducted that inspection. These officers have specialized ammunition training and the expertise necessary to perform kind, count and condition inspection. COCs were acknowledged by the ordnance officers at the delivery point. In these COCs, the contractor certified the ammunition provided was in

acceptable condition and could be safely fired, in an originally chambered weapon or weapon system.

Due to the off-the-shelf nature of the OCONUS-sourced non-standard ammunition, DCMA's inspection and acceptance services were very limited. For OCONUS to OCONUS shipments, these duties primarily involved processing payment after receipt of invoices and a COC signed by both the contractor and ordnance officer conducting the inspection.

DCMA has been a critical strategic partner in helping the buying command fashion a new acquisition strategy for Non-Standard Ammunition. Letters of Delegation requiring enhanced scrutiny of non-standard ammunition items have recently been accepted by DCMA. We have already performed some of these delegated functions on short notice in support of urgent ammunition requests. We are confident that the more stringent specifications and corresponding inspection and acceptance requirements will greatly enhance the likelihood that only conforming ammunition will be presented and accepted in the future. DCMA is fully engaged with our buying command partners to ensure we continue to improve the processes related to the acquisition and acceptance of non-standard ammunition.

In addition to the improvements already mentioned, DCMA's internal realignment enhances our contract administration operations. Subsequent to the award of this contract, DCMA realigned into product groupings, including the Munitions and Support Systems Contract Management Office, facilitating better

customer service and subject matter expertise minimizing the potential for situations like this one in an environment of increasing mission and constrained resources.

We appreciate the Congressional support of our efforts as the Department's primary contract management agency in providing our nation's warfighters and allies with quality products and services. Again, thank you for the opportunity to appear before this Committee today to address DCMA's role in this matter. I will now answer any questions the Committee may have.

Chairman WAXMAN. Thank you, Mr. Howell.
Mr. Mull.

STATEMENT OF STEPHEN D. MULL

Mr. MULL. Thank you very much, Mr. Chairman and Ranking Member Davis and all the members of the committee, for the opportunity to meet with you today to provide you some background on the Department of State's Watch List for Defense export licensing.

The Watch List is managed by the Directorate of Defense Trade Controls [DDTC], and that is part of the Bureau for Political Military Affairs which I lead.

The State Department has been responsible for regulating defense trade since 1935 with the objective of ensuring that defense trade supports U.S. national security and foreign policy interests. We carry out our work on the authority of the Arms Export Control Act and the Foreign Assistance Act of 1961, according to the International Traffic and Arms Regulations [ITAR], which includes the U.S. Munitions List [USML].

The USML covers items specially designed for military appraisals, and its 20 categories extend from firearms to the joint strike fighter. The Secretary of State has assigned the Bureau of Political Military Affairs the responsibility for performing this critical national security function for the State Department.

The Department's primary mission in this regard is to deny our adversaries access to U.S. Defense technology while facilitating appropriate defense trade with our allies and Coalition partners to allow for their legitimate self-defense needs and to fight effectively alongside U.S. military forces in joint operations.

We do this in part by screening all export applications against our Watch List, a large task given the volume of applications handled by the Department. In fiscal year 2007, the Political Military Bureau received approximately 81,000 licensing applications for exports valued at approximately \$100 billion. In fiscal year 2008 we anticipate that the trend of an average annual increase of 8 percent will continue.

Our Watch List is based on section 38(g) of the Arms Export Control Act, and that directs the Department of State, as designated by the President, to develop appropriate mechanisms to identify persons and entities who are ineligible to contract with the U.S. Government or to receive an export license.

The Watch List was created to respond to this section of law, as well as to help us identify other parties who might be unreliable recipients of Defense articles and services licensed by the State Department.

The Watch List currently has just under 80,000 entries drawn from a wide array of governmental and other sources. We update the Watch List daily with our compliance specialists, who continuously review intelligence information, law enforcement information, and open source information for relevant material.

Public lists such as the General Services Administration's Excluded Parties List, the Office of Foreign Asset Control's specially designated foreign nationals, and the Department of Commerce's Denied Parties List are all part of our Watch List.

The Watch List also includes persons who are subject to criminal or civil debarment by DDTC, as well as entries derived from classified intelligence reporting.

Additionally, sensitive information regarding ongoing criminal investigations is routinely provided to us by the FBI and Immigrations and Customs Enforcement senior special agents who are assigned and work with us in the Political Military Bureau and to serve as liaison among our agencies.

It is important to point out what the Watch List is and what the Watch List is not.

The Watch List functions mainly to alert our licensing officers and compliance specialists within DDTC about potential concerns regarding a party to a Defense export license application. The wide range of information and sources used in compiling the Watch List reflects the statutory requirements of the Arms Export Control Act and the wide latitude given the State Department in making the decisions regarding the exports of munitions.

Consequently, while some entries clearly determine whether an export may be approved—for example, if a party to a deal is debarred or otherwise ineligible to export—other entries tend to be of a more informational nature and are used in coming to decision on making licensing applications.

Consequently, the presence of an entity on the Watch List will prompt further scrutiny and review, but it doesn't automatically entail removal of the party or the denial of a license application.

Each license application submitted to DDTC is required by the regulations to include the names of all the parties who are involved in the proposed transaction. All of those parties, both foreign and domestic, are checked against this Watch List. If there is a match, the license application is immediately put on hold for a review by a compliance specialist.

If the party in question is debarred by the Department for a conviction under the Arms Export Control Act or otherwise ineligible—for example, if another U.S. Government agency has debarred them from contracting with the U.S. Government—or if they are under criminal indictment, they will be removed and the approved export application or the license will be denied.

If the Watch List entry indicates concerns in the activities of a particular party without rising to the level of removal or denial, DDTC's compliance and licensing officers will undertake a careful review and may request additional information from the applicant. Additional or clarifying information regarding the entity may also be sought from other Government agencies.

If it appears after review that original reasons for entering the party on the Watch List have been resolved, the hold will be released and the license will likely be approved without further delay.

We find the Watch List to be an effective tool to facilitate coordination with other Government agencies that may have a concern with the particular entity. For example, companies under criminal investigation may be Watch Listed to make sure that investigative agency, such as FBI or ICE, is alerted when a company applies for an export application. Such Watch Listing can facilitate a criminal

investigation by ensuring communication and coordination among Government agencies.

It is also worth noting that such coordination may confirm the suspensions of investigators, but it is also true that such coordination may demonstrate that a particular entity, in fact, is acting within the law, and helps ensure that investigative resources are not wasted on law-abiding companies.

Thank you for your interest. I will be happy to answer any of your questions about our Watch List.

Chairman WAXMAN. Thank you very much for your testimony.

Without objection, the questioning will commence with a 10-minute round for the majority followed by a 10-minute round for the minority. Either side may reserve any unused time of its 10-minute block for use during or immediately following a 5-minute round by a Member of that side, with this reserved time to be controlled by the chairman and the ranking member, respectively.

Without objection, that will be the order.

I am going to start off the questions, myself.

One of the questions we are trying to figure out at this hearing is: How can a company like AEY get such an important contract for \$300 million to provide ammunition to the Afghanistan Security Forces? Mr. Howell, in your written statement for today you explain AEY got the contract because of AEY's strong record of past performance. Here is what you said: "AEY had a history of satisfactory performance on similar contracts, showed increased revenue growth, adequate capitalization, and was considered a low risk." Do you stand by that statement?

Mr. HOWELL. Yes, sir, I do.

Chairman WAXMAN. Well, we did what the Army apparently never did. We looked back at past contracts to see what AEY's past performance under other contracts was really like. One contract that AEY got was a contract with the Multi-National Security Transition Command in Iraq to deliver protective helmets. A U.S. official who examined AEY's shipments wrote, "The helmets came to Abu Graib by mistake. They were not very good. They had peeling paint, and a few appeared to have been damaged such as having been dropped. When I first saw them, I put them in the reject category."

The same inspector also wrote this to Mr. Diveroli, the head of AEY: "Some people got a little wound up when they saw the daily receiving report. They remembered the 10,000 helmets you sold them earlier this year and the junk AKs we still have in the warehouse. Several scenarios were being planned for you, none of them pleasant."

Another official wrote, "Bottom line, the helmets are damaged goods and we don't want them."

General Phillips, does this sound like satisfactory performance to you?

General PHILLIPS. Sir, I am going to let Mr. Parsons address that question, but before I do that I would just like to state that when the officer goes in to make an award on a contract they do a thorough review of past performance and they ask DCMA to assist in that process, so—

Chairman WAXMAN. Well, if you did a thorough performance and someone came back with this kind of report of performance under a previous contract, would you think that sounded like satisfactory performance? Mr. Parsons, maybe you can answer this question.

Mr. PARSONS. No, I would not, sir. And, as I mentioned in my opening remarks, we have found that, due to dollar value of many of those contracts not being within the reporting threshold, a lot of that information did not get reported. Again, the reason why we are initiating a policy change in the Army to ensure that, regardless of dollar value, that type of information is sent forward.

I will say that—

Chairman WAXMAN. Well, I want an answer to this question and I have limited time. Under another Defense Department contract AEY failed to deliver 10,000 Beretta pistols under a contract for \$5.6 million. The contracting official who terminated that contract said this about Mr. Diveroli: "I just don't trust this guy. I couldn't take anything he said credibly."

The contracting official added: "All his reasons continued to build and build, and then it just got to the point where it was the straw and the camel's back, and I said, 'Look, no amount of consideration is going to take care of the fact that you have been unable to deliver. You have not had one delivery order come in.'"

Now, hearing that, Mr. Howell, would you think that indicated sound past performance?

Mr. HOWELL. I would not, if I heard those things, say it was sound past performance. But I would also question if those contracting officers, in fact, provided written input to the Excluded Parties List or other reference areas that we could use, in fact, to weigh our evaluation for adequate performance for our contractor.

Chairman WAXMAN. Well, under another contract with AEY, with the U.S. Army Special Operations Command, AEY was supposed to provide the same type of ammunition that it later delivered to Afghanistan. The contracting officer who terminated that contract said that AEY "failed to deliver acceptable goods, provided no notice of an excusable delay," and "provided inadequate assurance of future performance." Does that sound like satisfactory performance, Mr. Howell?

Mr. HOWELL. Absolutely not.

Chairman WAXMAN. The committee also looked at AEY's performance under contracts with other agencies. Under a contract with the State Defense to provide tactical equipment for use in Iraq, including optical sites and weapons adaptors, AEY repeatedly ignored a contracting officer's warnings. In fact, AEY delivered only one item by the delivery date, and it was rejected as a nonconforming substitute.

When the contracting officer withdrew the order, this is what he wrote to AEY: "You are hereby notified that your failure to deliver the listed items has endangered the performance of the Department of State mission. Further, in subsequent correspondence your promises of delivery have not been met. You are hereby informed that the undelivered items are being withdrawn from subject order. The DOS mission can no longer be delayed due to your inability to produce the items as stated in subject order."

Mr. Parsons, does that sound like satisfactory performance?

Mr. PARSONS. No, it does not, sir.

Chairman WAXMAN. The award of this contract to AEY despite these numerous examples of contracts terminated for poor performance reveals a fundamental flaw. The system for vetting contractors appears to be broken. It is hard to imagine a less-qualified contractor than AEY, and yet this company was rated excellent by the Defense Department and it was awarded a contract worth \$300 million. That is quite amazing to me.

I am going to reserve the balance of my time and I am going to yield to Congresswoman Norton her opportunity to ask questions.

Ms. NORTON. Thank you, Mr. Chairman.

Let me go first to Mr. Mull. You are aware, of course, that the Arms Export Control Act requires us to make sure that brokering, arms brokering overseas, is done in light of the national security interests of the United States. I want to look at the Watch List that you discussed in your testimony.

When there is an application for someone to be an arms broker, the Government is supposed to check all the parties on the Watch List specifically to see if these are arms traffickers. That is correct?

Mr. MULL. Yes. We compare every application for an arms brokering license against the Watch List.

Ms. NORTON. So this Watch List is very important, and we have learned—and I want to verify this—that everyone involved in the AEY contract was on the Watch List. Let's go first to the buyer, the president, Efraim Diveroli, flagged in April 2006 because of suspected illegal arms trafficking; is that not correct?

Mr. MULL. Yes, ma'am, that is correct.

Ms. NORTON. Although, Mr. Chairman, I would like to put their words on the record of the Watch List that, although Mr. Diveroli was only 21 years old, he has brokered and completed several multi-million-dollar deals involving fully semi-automatic rifles, and here are the operative words—"future license applications involving Diveroli and/or his company should be very carefully scrutinized."

Mr. Mull, that entry was placed in 2006; is that not accurate?

Mr. MULL. Yes, ma'am. And if I might elaborate, we actually first put the company AEY on our Watch List in January 2005.

Ms. NORTON. I have limited time. I just want to make sure that my questions are predicated on the facts. They are on the Watch List.

Now, the middleman, Mr. Mull, was Heinrich Thomet. Now, he was also placed on the Watch List in 2006 before this contract was awarded; is that not correct?

Mr. MULL. Yes, ma'am, that is correct.

Ms. NORTON. Now, the source of the ammunition was Mr. Pinari. He is the head of Albania's military export/import company. He was first listed, according to my information, in 2005; is that not true?

Mr. MULL. Yes, ma'am, that is correct.

Ms. NORTON. Now, we note that the entries of Mr. Thomet and Mr. Pinari came from the CIA and the DIA, and we understand that their information is classified, but the fact that they were on the list in 2005 and 2006 is not classified; is that correct?

Mr. MULL. That is correct.

Ms. NORTON. General Phillips, let me turn to you. The head of the State Department's Directorate of Defense Trade Controls [DDTC] told us that the AEY had "a perfect trifecta," and yet, of course, they were awarded by the Army a \$300 million contract. How do you explain awarding the contract to somebody who is on a Watch List that is not classified, sir?

General PHILLIPS. Ma'am, the contracting officers that execute the contracts are not required to go and look at the Watch List. I believe that to be true, and I will ask Mr. Parsons to just elaborate on that comment, if he would.

Ms. NORTON. Wait just a second. Your testimony here is that you didn't check the Watch List because you were not required to check—the contracting officer was not required to check the Watch List. I want to ask you, in light of what we now know, we know the contracting officer did not. And the last thing I am trying to do is to blame it on the contracting officer.

The only reason we are having hearings like this is to see what we can do to improve in the future, so I am not trying to say why in the world did you do it. In light of what you now know, would it not seem in the best interest of the United States to either, when you are involved in sales which require a license, to either check the Watch List or, if there is no requirement to have your own internal procedures so that the contracting officer would know to check the Watch List? Or is your testimony that we didn't have the procedures, we didn't have to do it, and we are not going to do it in the future?

Mr. Parsons.

Mr. PARSONS. Ma'am, I don't disagree. What I am not sure of is whether that Watch List is accessible to people outside of the DDTC. I can tell you that there is nothing in the regulation—

Ms. NORTON. Mr. Mull, was that Watch List which is not classified, if it had been asked for by the DOD, would they have been allowed to look at the Watch List?

Mr. MULL. We often get requests from other Government agencies and we evaluate it. We have to make sure that we don't release any classified information, so—

Ms. NORTON. This was not classified.

Mr. MULL [continuing]. We would screen in response to a Government agency. We would consider the request and provide what we could.

Ms. NORTON. Thank you. So this could have been released. It was not classified.

Mr. Chairman, I would like to ask if any procedures have, in fact, been set up to check the Watch List, before I sign off. Are there any procedures now within the DOD to check the Watch List now that, of course, you know that you have access to that information?

Mr. PARSONS. Ma'am, no, there is not to my knowledge, but we will pursue that with the Department of State. Our understanding was that Watch List fed the Excluded Parties List, which is what is required by the contracting officer, but we will engage with the State Department to see if there is a way that we can add that to our procedures.

Chairman WAXMAN. Thank you, Ms. Norton. Your time has expired.

I just want to ask a quick question of Mr. Parsons. One of the sources for the classified information was the Defense Intelligence Agency. Do you know now what the entry was?

Mr. PARSONS. Can you repeat the question, sir?

Chairman WAXMAN. One of the sources for the classification was the Defense Intelligence Agency. Do you know now what the deletion was?

Mr. PARSONS. With the DIA, no, I do not.

Chairman WAXMAN. You do not. OK.

We have another vote on the House floor. we are going to recess for around 10 minutes in order for Members to vote and come back.

We stand in recess.

[Recess.]

Chairman WAXMAN. The committee will come back to order.

I would like to now recognize Mr. Davis for 10 minutes.

Mr. DAVIS OF VIRGINIA. Thank you.

Mr. Howell, let me ask you, what does it take to be a non-responsible bidder?

Mr. HOWELL. Yes, sir.

Mr. DAVIS OF VIRGINIA. I mean, in retrospect you would say these guys are probably non-responsible, wouldn't you, for a \$200 million bid?

Mr. HOWELL. I would. Given the facts that we know today, I would tell you that they were a non-responsive contractor. They did not comply with the terms and specifications of the contract, which is a primary metric that we use. They didn't deliver on time, didn't deliver in accordance with the specifications in both the basic contract or the modifications.

Mr. DAVIS OF VIRGINIA. Let me just go through another company and ask if you think it is responsible. This is a company that in 2007 paid a \$1.1 million settlement for over-billing for aircraft parts, and in 2006 a \$30 million payment to settle claims that 100 neighbors in the Santa Susanna Field Nuclear Research Facility were sickened by decades of radioactive and toxic contamination. This was supposed to be confidential, but one of the plaintiffs divulged the terms to local media. In 2004, a \$615 million settlement to resolve the Darlene Druin scandal and other pending investigations, if you remember that.

In 2003 an \$18 million settlement for violations of the Arms Export Control Act and the International Trafficking in Arms Regulations. In 2003 a \$6 million settlement for violations of the Arms Export Control Act involving transferred data to China. In 2003 they paid a \$4 million fine for violations to the Arms Export Control Act and the International Trafficking Arms control. That is a different violation. In 2003 a \$2.5 million settlement for alleged defective pricing. In 2003 a \$490,000 settlement for a qui-tam action for false claims. They had had business units suspended from receiving new Federal contracts for an 18-month period from 2003 to 2005. Criminal investigations.

But this is the Boeing Corp., but they are responsible under the criteria because they can still deliver; is that how you view it?

Mr. HOWELL. Well, sir, the DCMA's ability to assess prior performance and potential responsiveness is directly limited to the data that we have and can review.

Mr. DAVIS OF VIRGINIA. Yes. That is all public data here. And they continue to receive. I guess what I am saying is it is a fairly low bar for companies. Really, debarment or not finding people responsible is basically a fairly low bar, isn't it?

Mr. HOWELL. Yes, sir.

Mr. DAVIS OF VIRGINIA. What did DCMA's review entail? Based on their review, a complete award was recommended. AEY was classified as a low financial risk at the time, and the firm was deemed well-managed, efficient, and experienced. Can you find where that information came from?

Mr. HOWELL. Yes, sir. We use a form 1403. That is what the procurement contracting officer submits for a pre-award survey. In that, in section 19 and 20 they have the ability to identify both major and contributing factors that they would like for the agency to examine for us to make a determination. The contracting officer, in accordance with the contract, the type of contract, meaning the priority, non-standard ammunition, previously manufactured, OCONUS-to-OCONUS delivery, requested that we perform a pre-award on the financial, transportation, and accountability aspects of this impending contract.

We did that for financial and transportation and the Defense Contracting Auditing Agency conducted the accountability piece of it.

Mr. DAVIS OF VIRGINIA. Were they aware that the CEO of this company was in his early 20's?

Mr. HOWELL. I cannot answer that question at this point, sir.

Mr. DAVIS OF VIRGINIA. Let me ask you, Mr. Parsons, Mr. Diveroli had some colorful off-the-field incidents, for lack of a better term. What effect do domestic incidents by contractors' presidents have on the awarding of a Government contract?

Mr. PARSONS. Sir, I have a hearing difficulty, so I just ask that you repeat the question.

Mr. DAVIS OF VIRGINIA. What effect to domestic incidents by a contractor's president have on the awarding of a Government contract? Any?

Mr. PARSONS. As far as his status, himself?

Mr. DAVIS OF VIRGINIA. Yes, for his off-the-field incidents.

Mr. PARSONS. They focus on the company, not on the people who own the company, unless they are on the Excluded Parties List.

Mr. DAVIS OF VIRGINIA. A 22-year-old CEO, I don't think he had a college degree—that doesn't send off any bells?

Mr. PARSONS. Sir, as part of the solicitation process, we don't ask for or even know what the age of the owners of the company are.

Mr. DAVIS OF VIRGINIA. Nobody did in the investigation of this or had any idea what was behind the paperwork?

Mr. PARSONS. Not that I know of.

Mr. DAVIS OF VIRGINIA. What if a contracting officer came across a news story where the president was arrested for domestic violence related charges? That would not be something that would necessarily ring any bells, because you look at the total company and not at the CEO?

Mr. PARSONS. Sir, if that was information that was available to the contracting officer, I am sure that would have caused some questions on their part. But, again, we are not aware of any of that information being available to the contracting officer.

Mr. DAVIS OF VIRGINIA. Could they have taken his age into account in deciding whether they could have been selected for an award of this magnitude?

Mr. PARSONS. Not his age. No. That is not one of the things that we use as a discriminator in awarding—

Mr. DAVIS OF VIRGINIA. How about experience?

Mr. PARSONS. Excuse me?

Mr. DAVIS OF VIRGINIA. Experience is one, though, isn't it?

Mr. PARSONS. Appearance?

Mr. DAVIS OF VIRGINIA. Experience.

Mr. PARSONS. Experience, yes.

Mr. DAVIS OF VIRGINIA. Experience is clearly a criteria, and at 22 the fact of the matter is he didn't have a lot of experience.

Mr. PARSONS. The information available to the contracting officer indicated that the company had relevant recent experience, that they had started in 1999, had awarded contracts by the Department of Defense starting in 2004, so the contracting officer, again, based on the information that was available to him, felt that the company had experience in providing these types of goods and services.

Mr. DAVIS OF VIRGINIA. Obviously they were wrong. You think in retrospect they were wrong, don't you?

Mr. PARSONS. They were wrong?

Mr. DAVIS OF VIRGINIA. Yes.

Mr. PARSONS. The contracting officer relied, again, on—if that was supplied on a contract that AEY had for—

Mr. DAVIS OF VIRGINIA. Do you think he made a good decision or a bad decision?

Mr. PARSONS. Based on the information that she had, I think she had—

Mr. DAVIS OF VIRGINIA. I am asking you in retrospect, now that we know all the facts.

Mr. PARSONS. In retrospect, knowing what we know now, it was not a good decision.

Mr. DAVIS OF VIRGINIA. That is all I am trying to get after.

I will reserve the balance of my time for this point.

Chairman WAXMAN. The gentleman has 3 minutes. He is reserving that.

I want to recognize Mr. Issa.

Mr. ISSA. Thank you, Mr. Chairman. And thank you very much for holding this hearing.

I am going to bifurcate my questions. I think the ranking member has done a pretty good job, a very good job of sort of asking the question of, in retrospect does this award make sense. No, it doesn't.

General Phillips, if I can ask you a question, knowing what you know from the record, what tools should have been used to prevent this from happening?

General PHILLIPS. Sir, this is non-standard ammunition that we are buying. It is essentially foreign-made ammunition, Soviet Bloc

countries, former Soviet Bloc. Some things that we have to do is to make sure that we improve our specifications, the way that we transport this ammunition, our packaging, standards, those kinds of things. And the team that I have established of subject matter experts have taken that on in a very big way and we have developed the standards and the specifications, and we are going to go off and improve those for future buys that we have for non-standard ammunition. We are going to do everything possible to ensure that this doesn't happen again, sir.

Mr. ISSA. I don't want to disagree with you. Your service in the Army is much longer than mine. But isn't this standard ammunition, just not our standard?

General PHILLIPS. Sir, for our standard ammunition——

Mr. ISSA. No, no. Please answer the question because I asked it that way for a reason. You know, there are three camps of ammunition in the world. There is the NATO standard, the old Soviet Tricomm standards, and then there is, like, all others. This is not all others, is it? This is basically the old anti-NATO communist block ammunition, AK-47s, a 7.62 that doesn't use the same casing as ours, and so on. It is what we dealt with all the way back in Vietnam; isn't that true?

General PHILLIPS. Correct, sir.

Mr. ISSA. Let me ask you a question, speaking of Vietnam. I was in Afghanistan almost immediately after we had secured it, and I was there with now Chairman Reyes and former chairman of Armed Services, Duncan Hunter, and we were shown by well-meaning, I am sure, Army officers how they were going to train the Afghans, the guys who, to a certain extent, had kicked the Soviets' ass with odds and ends weapons.

I know we are not supposed to use that word indiscriminately, but I noticed in the staff stuff I noticed there were some other words like shit ammo, so I figured, you know, kick the Soviets' ass would work very well. So I will limit myself to those two parts of George Carlin's repertoire for today in honor of George's passing.

But we were there with Duncan Hunter, and he looked at this stuff, and it was junk, and he asked, are we going to train with this? Oh, no, this stuff is terrible. This is what was turned in. We are paying to have this turned in by Afghans and none of it is useable. He said, well, when are you going to start training these guys? Well, we are looking into procuring weapons.

I asked that day what I am going to ask you today, although I asked it with a shorter list. Isn't it true that Bulgaria, the Czech Republic, Estonia, former East Germany, Hungary, Lithuania, Latvia, Poland, Romania, Slovenia, and Slovakia all use this standard historically, have large stockpiles, were known to have large stockpiles, and virtually all of these people, except for Germany, I guess, were part of the Coalition of the willing that went into Afghanistan; isn't that true?

General PHILLIPS. Sir, I am not sure. I believe that to be true.

Mr. ISSA. I said I would bifurcate this thing, but you led me right into the other part. Wasn't this an unnecessary contract, because the truth is if you are going to buy standard ammunition and you have colleagues, allies, friends, people you work with for whom this is still a standard, they know about it.

General, let me ask you a question: why are you wasting Federal taxpayers' time writing standards for tricom rounds when, in fact, all those countries I named have experts who not only have the ammunition and the weapons still in their stockpiles in many cases, but have people who have the expertise, and they are all NATO allies? Why is it in a NATO war in Afghanistan we didn't use our NATO allies' expertise not only in supply but also in inspection? And why aren't you doing it today as part of the fix?

General PHILLIPS. Sir, I would simply say that we are required by statute and by Federal regulation that when we enter into agreements with our foreign allies like Afghanistan we use specific policies and procedures that are defined by, in the case of the Army, the U.S. Army Security Systems Command.

Mr. ISSA. I am running out of time, so let me close with one question that is half comment/half question. You entered into agreements. You didn't go there to do it, but you entered into agreements with Afghanistan that essentially locked out the ability for our NATO allies who had large stockpiles from being the suppliers, either for reduced cost or in-kind.

Now let's go back again. If I take a trip to Afghanistan this week and I talk to President Karzai and I ask him, would you be willing to have this product delivered to you from any source that could deliver you high-quality product that your troops could use, do you think he is going to tell me, no, no, we have an agreement, we have a certain standard? Or do you believe that, in fact, the U.S. military in a macro way—and procurement is just the tail end of the macro mistake—made a mistake in Afghanistan that they continue to compound because we made a decision to use the weapons they were used to, and then we didn't work with the people who had the expertise?

General PHILLIPS. Sir, I agree with you that we have made mistakes and we need to capture those lessons learned and apply them.

The one thing I would like to share with you is that we are doing everything possible to ensure that our very important ally, Afghanistan, gets the munitions that they need, and that is my job, to make sure we do that now and in the future.

Mr. ISSA. Thank you, Mr. Chairman. I think we have made our point.

Chairman WAXMAN. Thank you, Mr. Issa.

Mr. Cummings.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

General, I just want to ask you a few questions. One of the things, as I listened to the testimony and reviewed all the documents, there are four things that seem to be going on here: serious communication problems, some serious incompetence, phenomenal carelessness, and a culture of mediocrity.

General, we reviewed documentation from the Defense Department involving quite a few previous contracts your agency had with this company, AEY. What struck me was the number of times AEY failed to perform and then came up with outlandish excuses for why it didn't fulfill the contract.

Let me give you a few examples.

In 2005 AEY was awarded a contract to provide munitions to the Iraq Security Forces, including 10,000 Beretta pistols. Mr. Diveroli was only 19 years old at the time. We interviewed your contracting officer for this contract, and he told us that when Diveroli failed to deliver the weapons, he just started making up wild excuses. This is your contracting officer, now. This is what he said: "Diveroli said the German government was interfering in the delivery of these Italian-made pistols. He said that the transport planes couldn't fly because of bad weather. He even said that there was a fiery plane crash that destroyed the documents necessary to secure an export license needed to ship the goods."

But that wasn't all. Mr. Diveroli said at one point that he failed to deliver the weapons because a hurricane hit Miami, FL, where AEY was based. He told a contracting officer that they had no water and that his life was just terrible. Well, as it turns out this wasn't true.

In an interview with the committee staff, this is what your contracting officer told us: "We could tell there was no hurricane in Miami. It wasn't like we didn't have the internet in the Green Zone."

General, are you concerned that Mr. Diveroli would make up such excuses like this on important Government contracts, major contracts?

General PHILLIPS. Sir, I appreciate your insight. I have not heard those allegations that you just went over in terms of the nine millimeter contract and others, but certainly it raises issue as to Mr. Diveroli, himself. In hindsight, if we had had knowledge, Army contracting, the contracting officer for the contract we are discussing, had knowledge of that and those instances in the past performance, that would have weighed in the decision that—

Mr. CUMMINGS. That is why I started off my discussion by saying one of four things, of four, are happening here. There are some serious communication problems; wouldn't you agree?

General PHILLIPS. Sir, I think when Mr. Parsons mentioned up front that in past performance and sharing that information, that we have to improve the way we do that. I would agree, sir.

Mr. CUMMINGS. So you did not know about this information that I just cited when this \$300 million contract was awarded? You didn't know?

General PHILLIPS. Sir, I did not.

Mr. CUMMINGS. Mr. Parsons, did you want to say something?

Mr. PARSONS. Sir, again, the information that the contracting officer had was limited from the standpoint of past performance. She did get a questionnaire on past performance answered by the Joint Contracting Command in Iraq and Afghanistan. Many of those issues that you just identified were not highlighted in that past performance review.

Mr. CUMMINGS. It is interesting that when Mr. Diveroli said a hurricane hit Florida and made his life terrible he was justifying his failure to perform on one of three contracts that your team was supposed to be reviewing to assess his past performance, and yet you didn't even talk to the primary contracting officer on the contract; is that right?

Mr. PARSONS. Sir, that is information I am not aware of.

Mr. CUMMINGS. Well, we did talk to him, and this is what he said. He told us, "I couldn't take anything Diveroli said credibly." He concluded that Diveroli was lying to him. That is his statement. And this wasn't the only person telling us this. Another contracting official became suspicious when AEY sent helmets accompanied by a cryptic Chinese document supposedly showing they were safe. This official told us, "I just don't trust the guy." And there are many more examples like this. It just seems like if you didn't know this, then we have a fundamental problem with the way we do business. The entire system must be broken.

I heard what you said, General, about the corrections that you plan to make, but I don't know that those corrections deal with the four things that I talked about—the communications problems, incompetence, carelessness, and a culture of mediocrity.

I am hoping that the things you said will correct this, but I am going to tell you I don't have a lot of faith.

Chairman WAXMAN. Thank you, Mr. Cummings.

Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman.

Mr. Chairman, I want to thank you for holding this hearing, and I want to thank the ranking member for his work, as well. This is very important.

You know, there has been some reluctance, I think, of the panel, and I appreciate your coming in here and testifying, but there has been a reluctance on the panel to criticize what happened here. I just want to go on the record to say that all of us have spent a lot of time in Iraq and Afghanistan and we have seen the excellence with which our military has performed. The events here that we are speaking of today are a disgrace. They do not meet the standards of those men and women in uniform that we have seen repeatedly in our visits to Iraq and Afghanistan. That is the great sin here. This does not meet acceptable standards, not even close.

I am not hearing that from the panelists. I am hearing hedging, I am hearing some defenses about information not being available. This kid was 19 years old, 19 years old. He gets a \$300 million contract, taxpayers' money from the United States of America. That is a disgrace. I don't hear that from the panelists. I am hearing defense of different individuals.

Has anybody been fired for this? Can I ask the panel, anybody get their walking papers for what has happened here? Has anybody been fired?

Mr. PARSONS. No, sir. No one has been for instance fired.

Mr. LYNCH. I am sorry?

Mr. PARSONS. No one has been fired.

Mr. LYNCH. Well, that is a shame. That is a shame because in the private sector somebody would be without a job because of this.

I have to ask you, as well, I know the two individuals were indicted, but it looks like, based on the information here, because the standards are so lax, it doesn't look like they broke the law. It looks like these guys could walk, even though they are indicted, because there are no standards for age of ammunition, and they knew it, so I am very concerned about that.

I hear and I read that the contracts have been canceled, terminated. Now, I was in Iraq at the Taji Weapons Depo a few weeks

ago and I asked the commanding general there about the AEY contract. He said, Yes, they are shipping in to us. So myself and Mr. Platts from Pennsylvania actually asked the general to give us a detail, and we went around and started opening up some crates. They were all AEY contract. It looks like they are still performing in this contract. That doesn't jive with the testimony and the documents that I have before me.

Can you tell me, is AEY still performing on some contracts in Iraq?

Mr. PARSONS. Sir, I am not aware. I will have to get back to you on whether they are still performing on a contract in Iraq.

Mr. LYNCH. That is not good enough.

Mr. PARSONS. I can tell you on this—

Mr. LYNCH. That is not good enough, sir.

Mr. PARSONS [continuing]. Ammunition contract they are not.

Mr. LYNCH. I will get back to you—that is not good enough. Considering what these kids did to the American taxpayer, there should be no question in anyone's mind that these contracts have been terminated. That just sends the wrong signal to these contractors that someone could do this and still get paid and still perform under other related contracts. I mean, this individual, Efraim Diveroli, had seven contracts that were unsatisfactory previous to this.

What bothers me is that a lot of this information was laid out there. The sourcing committee on this most recent contract declared that he was unsatisfactory. Then the defense contracting officer changed that assessment, changed it from unsatisfactory to good and allowed the contract to be granted. So I would be asking if there was an investigation regarding that individual who turned the recommendation around after we had all the information before us.

The fact that I think, based on what I saw with my eyes, AEY is still performing contracts for the U.S. Government. That is based on my own assessment in person in Taji and Iraq with Mr. Platts and some others.

Also, there is another individual here, Mr. Merrill. It appears, at least from the documents in front of me, that you asked for verification and assessments from individuals about the way these contractors performed. One of the things that gets me is that in assessing how a contractor performed you asked the vice president of AEY how are you doing. He has a major financial interest in this company, and he filled out the form and said we are doing great. You asked the vice president of the company to do an assessment of his company. How do you think that is going to come back? I mean, that is just a systemic gap here. I wish we weren't at this point.

I think we have to scrap this whole system and come up with something that is more worthy of our men and women in uniform, because this has taken resources away from them, it is basically stealing taxpayer dollars, and it is putting them in jeopardy.

I am beside myself. I am absolutely beside myself about this whole deal. All the money and time we are spending here, this is a mess. It is a mess. It is a disgrace.

Chairman WAXMAN. The gentleman's time has expired.

Mr. LYNCH. I will yield back. Thank you, Mr. Chairman.

Chairman WAXMAN. Thank you.

Mr. DAVIS OF VIRGINIA. Mr. Chairman, let me claim my 3 minutes, if I could, really quick.

Chairman WAXMAN. Yes, sir.

Mr. DAVIS OF VIRGINIA. Could I just ask why this was a requirements contract as opposed to a multiple-award IDIQ or something like that? Why was this vehicle chosen?

Mr. PARSONS. Congressman Davis, it is my understanding, after talking with the contracting officials on this, that when they were discussing the requirements for the Afghanistan ammunition they could not get the customer to specify a minimum amount of ammunition that they would need to place a minimum order against an IDIQ contract. So instead they elected to use a requirements contract, which doesn't require us to necessarily award a minimum requirement.

Mr. DAVIS OF VIRGINIA. OK. Now, this was a small business that got the contract at the end of the day. Who checked to see if their certification was accurate? Is this the contracting agencies? Is it the SBA? Or is it a competitors' complaint? How does that work?

Mr. PARSONS. Sir, the contractors certified in their certification representations that they were a small business. The contracting officer verified that they were a small business and coded that in the Federal procurement data system as a small business.

Mr. DAVIS OF VIRGINIA. That could have been protested if somebody wanted to protest, but it was not in this case, right?

Mr. PARSONS. The small business size was not a factor in deciding. This contract was open to large businesses and small businesses.

Mr. DAVIS OF VIRGINIA. Right. But if a small business competes in this, don't they have an advantage?

Mr. PARSONS. What was that last part again?

Mr. DAVIS OF VIRGINIA. If a small business competes, it isn't there some advantage to that?

Mr. PARSONS. Correct.

Mr. DAVIS OF VIRGINIA. What is the difference between a small business and a small disadvantaged business?

Mr. PARSONS. Sir, the small disadvantaged business are those companies that meet the qualifications of the Small Business Act for being identified as disadvantaged for either minority status or for other aspects of it. I don't have a complete list off the top of my head on what those are, but there is definitely something that has the difference between the small business and small disadvantaged business.

Mr. DAVIS OF VIRGINIA. I know what it is. What is your understanding of the certificate of competency process and the role of the SBA?

Mr. PARSONS. Sir, my understanding is that if there is a question on the part of the contracting officer regarding the responsibility of the small business, they go to the Small Business Administration and ask for a certificate of competency for that small business.

Mr. DAVIS OF VIRGINIA. Now, when a contracting officer has to interface with officials from SBA, what are the procedures? Do they just ask for it and the SBA then will do appropriate checks?

Mr. PARSONS. Yes. They correspond directly with the Small Business Administration and give them all the particulars regarding the issue and wait for the SBA to make an assessment.

Mr. DAVIS OF VIRGINIA. So how much information does the contracting officer share, and how knowledgeable does the SBA have to be in understanding the nuances of a specific acquisition?

Mr. PARSONS. I am not certain, sir.

Mr. DAVIS OF VIRGINIA. OK. How frequently does the SBA effectively reverse a contracting officer's responsibility determination during the processing? Do you ever see that?

Mr. PARSONS. Again, sir, I do not know.

Mr. DAVIS OF VIRGINIA. Have you ever seen it?

Mr. PARSONS. I have never seen the SBA reverse one, no.

Mr. DAVIS OF VIRGINIA. What challenges does your agency have with the SBA certificate of competency process, particularly in an acquisition to be awarded on the basis of a low price, technically acceptable offer?

Mr. PARSONS. I am not certain.

Mr. DAVIS OF VIRGINIA. You don't feel you have any challenges, or do you have challenges with the SBA certificate of competency process, particularly in an acquisition that is awarded on the basis of the low price, technically acceptable offer? Any problems?

Mr. PARSONS. Sir, again, for this particular acquisition I am not aware of any issues regarding the competency, the certificate of competency with SBA. There wasn't any engagement at all with the SBA in this acquisition process.

Mr. DAVIS OF VIRGINIA. But they weren't competent at the end of the day?

Mr. PARSONS. Correct.

Mr. DAVIS OF VIRGINIA. Thank you.

Chairman WAXMAN. Thank you, Mr. Davis.

Ms. Watson.

Ms. WATSON. I want to thank the chairman very much for having this hearing today, and I thank the panelists for coming forth.

As we look into the background, we find that in 2006—it was December—Mr. Diveroli and Mr. Packouz allegedly beat a valet parking attendant, resulting in charges of battery and possession of a stolen or forged document against Mr. Diveroli and a battery charge against Mr. Packouz.

In January 2007 AEY was awarded a \$298 million, 2-year contract by the Defense Department. The president of AEY, Efraim Diveroli, was 21 years old at the time that the contract was awarded, and the vice president, David Packouz, was 25 years old.

I just heard one of the witnesses say that we don't look at age. Well, suppose they were under-age, 16 and 17? Would you not want to be aware that they were not adults?

And on Friday both of them and three other AEY officials were indicted on charges that they concealed the Chinese origins of AEY's ammunition shipments from Albania to Afghanistan.

If the investigation revealed that there was a contract to buy Chinese goods, which would be illegal in this regard, how is it that the Department of Defense and the contractors did not know the background that I just read? Somebody is not doing the work that they should. They are not being accurate.

I want to ask Mr. Mull, Were you aware of the contract with the Chinese for the goods?

Mr. MULL. The contract with the Chinese?

Ms. WATSON. Mr. Jin had notified the factory before and after the production of 100 percent inspection of the vests to make sure that there were no Chinese markings anywhere on the vests or on the box, and I understand there were markings there. It is kind of like, as I understand, a bait and switch thing that AEY did, and there is a history of this kind of thing. I understand that there as some, I guess, relationships and some purchase long before this contract. Were you aware that they were buying these goods from the Chinese?

Mr. MULL. No, ma'am, I was not. But, because that was not part of an export of weapons from the United States and munitions from the United States, which is what we are solely responsible for regulating, we wouldn't necessarily have been aware of that. But, to answer your question, no, I was not aware in this particular case.

Ms. WATSON. Well, the documents that were obtained by the committee seemed to show that AEY concealed these Chinese origins by claiming that the vests were made in South Korea and were only shipped through China. This is how the AEY official described this plan: "Harry, I just spoke to Efraim, and here is how we could resolve this situation. Please advise."

"The commercial invoice would show that the shipper is a South Korean company, and we have the letterhead, and that you and your contact in C"—meaning China—"is just the export company."

Mr. Mull, again, would concealing the true Chinese origins of goods under a State Department contract be a violation of law?

Mr. MULL. Well, if someone was exporting Chinese sourced munitions, we would not give a license to someone to export munitions from the United States from China overseas; however, again, in the State Department we do not regulate foreigners dealing with one another overseas.

Ms. WATSON. According to the indictments of last week, the Justice Department is examining the Chinese origin of the ammunition AEY provided from Albania to Afghanistan under the Defense Department's \$300 million contract, but the committee now has evidence that AEY may have concealed the Chinese origins of other goods, including the bullet-proof vests.

Mr. Chairman, I suggest that we share with the Justice Department the information we obtained to make sure that they are aware of it. I am just appalled that we don't have sharper people, that we are not doing better background checks. To have a company like this get away with it and use \$300 million of taxpayers' money is abominable.

Thank you, Mr. Chairman.

Chairman WAXMAN. Thank you, Ms. Watson.

Mr. Platts.

Mr. PLATTS. Thank you, Mr. Chairman. I appreciate your holding this hearing.

I want to associate myself with comments from previous speakers, especially Mr. Lynch. As he referenced, we traveled together in April and had some conversations regarding AEY and their supply.

I want to followup on the last speaker, Mr. Mull, on the issue of the Department of State's role here. It is my understanding that Department of State does the licensing for any firm that wants to engage in brokering sale of arms, munitions overseas. As part of that process, there is a Watch List maintained from intelligence officials, law enforcement, other entities, developed. It is also my understanding that one or more individuals or entities associated with the AEY contract were on that Watch List.

I guess my first question is: given that, how did AEY get a license? Was the information that led to them being on that Watch List investigated before a license was issued?

Mr. MULL. Yes. Of the 17 licenses that the State Department issued to AEY, we consulted with law enforcement agencies that were involved with and looking at the activities of the company, and we checked with them to make sure that issuing this license would not obstruct any of their investigations or that it would otherwise break the law.

We are required by the Arms Export Control Act to make decisions on these applications for export licenses according to certain criteria laid out in the Arms Export Control Act. In the licenses that we did approve, there was nothing illegal that they were proposing, and we confirmed that in consultation with the appropriate law enforcement agencies.

Mr. PLATTS. Maybe I am misunderstanding the intent of that Watch List. It is not that they are proposing anything illegal, but the fact that they are under investigation seems some bells would go off that maybe we need to wait until those investigations are completed before we issue new licenses. Is that not part of the consideration of whether a license is issued or not?

Mr. MULL. If the company is on the Watch List, yes, a bell will go off and automatically it will attract more intensive attention from our licensing specialists and our compliance specialists to see if there is anything about that particular case that would be a violation of U.S. law. In those cases where we issued the licenses, we made the determination in those discrete cases that there was nothing illegal.

Mr. PLATTS. I guess I would add to colleagues who expressed somewhat disbelief that, given the circumstances here, a company with such a small record of engagement in this area was on a Watch List, the age of the company executives combined, that then we go ahead and issue a license that leads to a \$300 million contract. So I guess my understanding of what scrutiny would result from that Watch List is more perfunctory. As long as there is no illegal conduct identified, the fact that they are under investigation isn't going to cause a license to be withheld. It sounds like it has to be something identified, yes, they are proposing something illegal or yes, they have done something illegal, not there are lots of questions here about whether they are worthy of this license.

Mr. MULL. Well, sir, we did not issue a license for the \$300 million—

Mr. PLATTS. That is a separate contract.

Mr. MULL. Right.

Mr. PLATTS. But you issued a license to allow them to engage in the activity that led to them being able to get contracts.

Mr. MULL. No. These were separate contracts where they sought to export U.S.-provided supplied weapons to overseas.

Mr. PLATTS. Right.

Mr. MULL. And we carefully vetted to make sure that the things they were selling overseas was not a violation of law.

Mr. PLATTS. OK. What sharing of information from your Watch List goes to DOD when they are looking at issuing contracts such as this? What information that you had that led to them being on a Watch List is shared with DOD?

Mr. MULL. Because so much of what we have on the Watch List comes from intelligence agencies and other classified sources, we cannot freely share it. But what we would do—

Mr. PLATTS. Even with DOD?

Mr. MULL. That is right, because we have to respect the originators of the classified information. The originator ultimately determines who can see it. So what we do gladly—and Mr. Parsons and I were talking about this during the break—that if there were an entity or a person that any part of the DOD was looking at for consideration for a contract, if they provided us with the name or the person we would be happy to run that name against our List. If we saw a hit, we would then consult with the originator of the information, say, Hey can we share this with the Defense Department?

Mr. PLATTS. So that is something you are discussing today, but as of today the information that leads to the Department of State to be concerned about individuals or entities to put them on a Watch List, DOD today has no access to that information?

Mr. MULL. We receive on multiple occasions from many different Government agencies who are aware of the Watch List, they contact us and ask us to check, and so we have done that in the past.

Mr. PLATTS. But there is no standard protocol that if you put somebody dealing with the sale or brokering of ammunition or weapons on a Watch List, that there is no automatic sharing with DOD that buys a lot of ammunition and weapons, that there is not an automatic sharing, hey, just so you know, this entity or this individual has been put on our Watch List, so you may want to take a closer look if you are going to purchase, including a \$300 million contract? That doesn't happen today?

Mr. MULL. No, sir. We do not push out the information, but if we are contacted we—

Mr. PLATTS. I think that is one of the problems, that one branch of our Government has information that raises some concerns is not automatically sharing it with another entity within our Government that is engaged in the purchase of the underlying product, ammunition and arms. I appreciate that dialog is beginning on how to strengthen that, and I think that is what we are after in this oversight hearing. How do we make sure this doesn't happen again.

Mr. MULL. Yes. Sir, if I might, one of the concerns that we have, we have close to 80,000 entities on this List, and much of the information is controlled, and so we wouldn't know. Much of it comes from other classified controlled sources. We would need the originator of the information's permission to push that out, and so it would be difficult on a list that long—

Mr. PLATTS. My time is up. Given the level of classified clearance in the Department of Defense equal to anyone at Department of State, we should be able to find a way to share that information in a seamless fashion.

I thank each of you for your testimony, and also for your service to our country.

Thank you, Mr. Chairman.

Chairman WAXMAN. Your time is up.

Mr. Braley.

Mr. BRALEY. Thank you, Mr. Chairman.

There have been a number of disturbing issues raised by this investigation, but Mr. Mull I want to talk to you about one that specifically relates to the role of the U.S. Embassy in Albania and the potential coverup of the countries of origin of this ammunition.

Yesterday Chairman Waxman sent a letter to Secretary Rice asking about reports that the U.S. Ambassador and other officials at the U.S. Embassy at Albania approved a plan to conceal the Chinese origins of the ammunition that AEY supplied to the Afghan Security Forces. The committee received this information from Major Larry Harrison, the Chief of U.S. Office of Defense Cooperation in Albania.

During an interview with this committee, he stated that the Ambassador and his top aides held a late-night meeting with the Albanian Defense Minister to discuss how to respond to a request by the New York Times to visit the site where AEY was removing Chinese ammunition from its original packaging before sending it to Afghanistan. According to Major Harrison, who was at that meeting, the Albanian Defense Minister ordered one of his top generals to remove all evidence of Chinese packaging before the site was inspected the following day.

Although Major Harrison was "very uncomfortable" with these actions, he told the committee that "the Ambassador agreed that this would alleviate suspicion of wrongdoing."

Mr. Mull, I know you were invited here today to testify about the Watch List, but do you have any further information from the State Department regarding this specific issue?

Mr. MULL. No, sir, I do not. All I know is what I read in the chairman's letter yesterday and in the press accounts yesterday, and I do know, while I am personally not aware of any wrongdoing on the part of the management of our Embassy in Tirana, I do know that the State Department plans to respond to these serious allegations in the appropriate channel once they have collected the information.

Mr. BRALEY. Well, let me just ask you then hypothetically, assuming that a U.S. Ambassador to a country like Albania had sat in a meeting like the one I described and was aware that an intentional act was being committed to conceal the identity of the country of origin in violation of U.S. military procurement requirements, would you agree that would be a bad thing for that Ambassador to do without reporting?

Mr. MULL. Sir, I am reluctant to answer a hypothetical question, because I can imagine there might be circumstances in which covert activity is involved of the transfer. I would—

Mr. BRALEY. I am just going to have to stop you right there. I am having a hard time understanding how a covert activity would justify an intentional violation of U.S. law. Can you explain any situation where that would be acceptable?

Mr. MULL. I think any violation of U.S. law by any U.S. Government official is unacceptable.

Mr. BRALEY. What potential remedies are available against a U.S. Ambassador who participates or allows the concealment of a country of origin of ammunition that is being shipped to an ally of this country?

Mr. MULL. Sir, I am afraid I personally can't provide you the answer to the question because I don't work on disciplinary matters or investigative matters outside of the arms export business from the United States, but I would be pleased to take your question back to the appropriate authorities.

Mr. BRALEY. I would appreciate that.

[The prepared statement of Hon. Bruce Braley follows:]

**Statement of Congressman Bruce Braley
Committee on Oversight and Government Reform
"Examination of AEY Contracts with the U.S. Government"
June 24, 2008**

Thank you, Chairman Waxman and Ranking Member Davis for holding this important hearing today examining U.S. government contracts with AEY.

I believe it is disturbing that a 21-year-old with a criminal record could be awarded an almost \$300 million contract to provide Afghan security forces with ammunition. I am very concerned by reports that AEY illegally purchased ammunition manufactured by China and fraudulently certified ammunition made in China as being Hungarian. I am also concerned by reports that AEY provided substandard, Cold War-era ammunition from aging and decaying stockpiles in Eastern bloc nations, and by reports that AEY may have worked with middlemen on a federal watch list of entities suspected of illegal arms trafficking.

It is unacceptable that the primary supplier of ammunitions for the Afghani police force would issue those forces substandard ammunition, and break American law in order to do so. I also believe that the flawed contract with AEY is indicative of larger government contracting problems, and is just one of many examples that we have seen where a lack of oversight, accountability, and high standards for contractors have led to an abuse of taxpayer dollars and have possibly hindered the U.S. mission in Iraq and Afghanistan. The broad scope of

the problem is evidenced by the fact that in addition to providing munitions for Afghan forces, AEY has also provided ammunition or equipment to the Department of Energy, the Environmental Protection Agency, the Transportation Security Administration, and the State Department, as well as to the American military in Iraq.

I am glad that the Army has undertaken a broad review of procedures used to supply security forces in Afghanistan and Iraq with foreign arms, and that the Army plans to overhaul some of their arms-contracting standards and procedures. I am also pleased that the Army is specifically examining how it orders foreign munitions and supervises their quality, packaging, and shipment. This review and overhaul are clearly necessary in light of the problems with the AEY contract.

I am hopeful that this hearing will shed light on the reforms that are necessary in order to ensure increased oversight and accountability of U.S. government contracts. I also hope that this hearing will lead to changes which will help ensure that future government contracts are only issued to responsible, ethical, and qualified companies that will actually help U.S. efforts in Iraq and Afghanistan.

Thank you again, Chairman Waxman, for holding this hearing today, and thank you for your leadership on this issue. I look forward to hearing the testimony of the witnesses.

Ms. WATSON. Mr. Braley, would you yield a second?

Mr. BRALEY. I would.

Ms. WATSON. As a former Ambassador, you would be recalled from your post in no time. That is the remedy.

Thank you, Mr. Chairman.

Mr. BRALEY. Reclaiming my time, the other question raised in the letter that Mr. Waxman sent yesterday to the Secretary of State is that the Embassy apparently concealed information about this meeting from the committee, and the committee specifically asked for information about meetings between Embassy officials and the Albanian Defense Ministry, as well as any information about any interventions into AEY's repackaging operation.

Although Major Harrison argued internally that the Department should inform of us of those activities, he was overruled, and he provided documents contemporaneously to back up his story.

Chairman Waxman made a new request yesterday for all the documents relating to this meeting and for a series of interviews with the Ambassador and his top aides. Mr. Mull, can you tell us whether the State Department intends to comply with that request voluntarily?

Mr. MULL. Sir, I am sorry, I can't answer the question. I don't know what the intention is of the senior Department leadership, except that we will respond to the chairman's request through the appropriate channel.

Mr. BRALEY. Well, let me tell you why this is so serious and why this committee takes this so seriously. A BBC News report says that Major Harrison was replaced in his position in the Embassy on June 9th. Do you know if that is true?

Mr. MULL. That is the first I have heard of it, sir.

Mr. BRALEY. General, Mr. Howell, do you have any knowledge of whether that occurred?

General PHILLIPS. No, sir.

Mr. HOWELL. No, sir, I don't.

Mr. BRALEY. The reason why that is important is because Major Harrison was a Defense Department official, and if there was any retaliation against Major Harrison, that would be a serious issue, particularly since June 9th was the very same day he was interviewed by this committee.

Mr. Chairman, I would certainly hope that the committee will look closely into this matter and followup on any further investigation to protect Major Harrison as a potential whistleblower.

Chairman WAXMAN. Thank you very much, Mr. Braley.

Mr. Tierney.

Mr. TIERNEY. Thank you, Mr. Chairman.

You know, I am trying a little bit here to understand how the Defense Department came to the conclusion that AEY's past performance was excellent and that there was no history of quality-related problems. If you just look at the report that we put together and some of the information, they had an Army Special Forces Command contract for ammunition terminated in 2005 because of late deliveries and poor quality, an Army contract for gun scope mounts terminated in 2006 because of its failure to deliver after two extensions, a State Department contract for weapon systems terminated in 2007 because they provided the wrong items. The

Defense Department terminated four delivery orders under a larger contract to supply munitions to Iraq Security Forces because the company failed to deliver the goods, including 10,000 Beretta pistols.

General, I am curious. How can there be a conclusion that there is no history of poor performance when the Government agencies had terminated at least 11 different contracts?

General PHILLIPS. Sir, I believe your comments and what you described are true, but when you go back and you look at the decision that the contracting officer made, based upon the information that was available to that contracting officer, she made a reasonable decision based upon the information that she had, the past performance information, and the pre-award survey that was done by the Defense Contract Management Agency.

Mr. TIERNEY. Let's take a look at that. They did talk to her. She was interviewed, and she said she had never heard of those terminations. That, I guess, is what is stunning on that. She said she checked the Army's Past Performance Management System data base—I would think that should have had the information—and there was no negative information about AEY.

So I guess, General, if that system has such serious flaws, what has been done to correct that?

Mr. PARSONS. Sir, if I may, I will address that. We are initiating policy changes in our past performance reporting to ensure that type of information, regardless of dollar value of the contract, is captured. Part of the problem we have today is past performance reporting is only required when these types of contracts are \$5 million or more. Many of the contracts I believe you describe were below that threshold, and so there was no requirement to do the reporting. However, what we are going to initiate is, when there is evidence that the contractor is not complying with terms and conditions of the contract and is terminated for default or terminated for cause or a show cause letter is issued for poor performance, that will be recorded in the past performance data system in the future.

Mr. TIERNEY. I mean, it is unbelievable that it wouldn't have been done in the past. I mean, who is responsible for that, and do they still have their job? Who is responsible for keeping that list up and keeping it accurate? Has there been any accountability for the fact that these past performance problems weren't even on that list?

Mr. PARSONS. The contracting officer is required to update past performance information on those contracts that meet the threshold, so that is the contracting officer requirement, commonly shared with the program office. But, again, in our review of many of the contracts where they have been terminated for default, none of those contracts met that dollar threshold. Again, that is a hole in the system that we have to repair.

Mr. TIERNEY. You know, the Beretta pistols were \$5.6 million, as has been pointed out to me. I think some of those did hit the threshold.

Mr. PARSONS. Sir, that information is new. I am not aware of that \$5.6 million contract or when that contract was actually terminated.

Mr. TIERNEY. I guess that is the problem: nobody else was, either.

Mr. PARSONS. None of the ones I saw were that threshold.

Mr. TIERNEY. Let me change directions here just for a second. There is a fellow named Mr. Ralph Merrill who was also indicated last week. According to an e-mail that he sent back in March 2006, he identified himself as the vice president of AEY.

Mr. Howell, did you know that Mr. Merrill was a vice president of that company in 2006?

Mr. HOWELL. Not at the time, no, sir.

Mr. TIERNEY. Later that year in December 2006 Mr. Merrill was involved in helping AEY obtain its \$300 million contract with the Defense Department to provide ammunition to the Afghan Security Forces. In December 2006 he stated he would support AEY's efforts to perform on the contract by reserving \$1 million as working capital to be dispensed against purchase orders. He did this as the president of a company called Vector Arms.

Mr. Howell, that information was submitted to your agency during its survey of the company AEY's financial capability. Your agency was informed that he had a financial interest in the success of that contract; is that right?

Mr. HOWELL. Yes, sir, as far as I know.

Mr. TIERNEY. OK. Now, the committee talked to the contracting officer who ordered that ammunition contract, and she told us that Mr. Merrill even joined Mr. Diveroli in a meeting with her discussing the requirements of the contract. She said Mr. Merrill identified himself as a consultant to the company at that time. So we probably don't have any problem with him being vice president/financial backer/consultant, but the fact of the matter is the Department awarded the contract based on the conclusion that AEY had an excellent past performance, and in part that conclusion was issued on questionnaires that were submitted to contracting officials on only three of AEY's contracts.

So I guess one problem would be they only went to three of the prior contracts to get information. But one of the questionnaires was sent to Mr. Merrill, whose company had a prior contact with him, and, of course, Mr. Merrill gave him excellent reviews. He had a conflict of interest. There is something wrong here where you are asking somebody that has a huge financial stake in a current contract that is being sought and asking him about past performance on contracts that he also had an interest in. How can you get an unbiased and objective assessment of past performance from someone who has a financial interest in the contract?

Mr. HOWELL. First, sir, at the time, as I mentioned, we had no knowledge that the gentleman was a vice president of the company, but when we conducted our pre-award—

Mr. TIERNEY. He represented himself as a vice president of the company. He sent an e-mail to you telling you he was vice president of the company in March 2006.

Mr. HOWELL. Sir, I am not sure of the timing of that correspondence—

Mr. TIERNEY. March 2006.

Mr. HOWELL. I am not sure of the timing of that correspondence as it related to the timing of the pre-award survey. Subsequent to

the request for pre-award survey, we looked at several financial aspects of the company. That was one of them. And the rating was that they were financially capable of conducting a brokerage operation.

Mr. TIERNEY. And you made that decision based on three questionnaires of the companies, at least one of which had a very serious conflict of interest. I think that is the issue here. You have to do something, I would hope, with regard to that process to make sure that doesn't continue to happen.

Mr. HOWELL. DCMA has begun a review of all of its processes related to that, and we are looking at the implementation of different policies that will prevent those occurrences in the future.

Mr. TIERNEY. I yield back, Mr. Chairman. My time has expired.

Chairman WAXMAN. Thank you very much, Mr. Tierney.

Gentlemen, we thank you for being here and answering our questions, and we hope this hearing will serve a constructive purpose, because what we have been talking about is not a proud day for contracting for our country.

We stand adjourned.

[Whereupon, at 12:12 p.m., the committee was adjourned.]

[The prepared statement of Hon. Diane E. Watson follows:]

**Opening Statement
Congresswoman Diane E. Watson
Committee on Oversight & Government Reform
Hearing: "Examination of AEY Contracts with the U.S. Government"
June 24, 2008**

Mr. Chairman thank you for holding today's hearing that will examine the Defense Department's judgment in awarding the Afghan Security Forces contract to a company that could not carry out the duties assigned to them, and to address the failure of AEY, Inc. to provide weapons and ammunition to the Afghan National Army and Afghan National Police Force.

In January 2007, AEY received the Afghan Security Forces contract, a two-year agreement worth \$298 million dollars. 14 months later, in March 2008 the Defense Department suspended AEY from any

future contracting opportunities with the Executive Branch of the Federal Government. The reasons for the suspension were AEY illegally purchased ammunition in Albania that was manufactured in communist China, executives knowingly made false statements about the origins of the ammunition by claiming in it certified statements the materials were purchased in Hungary.

Last week, on June 19th the president of AEY, Efraim Diveroli, and the Vice-President, David Packouz were indicted on 35 counts of procurement fraud, 35 counts of making false statements, and one count of conspiracy.

As this committee investigates the conduct of AEY to determine why they acted in what seems to be a

malicious manner, and to figure out why the Defense Department was apparently asleep at the wheel when they awarded the contract, I hope we can find solutions to prevent and deter this type of business practices in the future.

Once again we find our nation squandering hundreds of millions of dollars. Millions that could be used for education for our children, healthcare for the 40 million people uninsured, and revitalization of our ailing infrastructure.

Mr. Chairman, I thank the panelist for cooperating with the committee, and I look forward to their testimony. I yield back.